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Court Affirms Tiered Rate Structure in San Juan Capistrano Ruling *East Valley Water District's tiered rates meet Proposition 218 regulations*

Highland, Calif., (May 1, 2015) – The 4th District Court of Appeals recently ruled in a case against the City of San Juan Capistrano finding that Proposition 218 requires water agencies to pass-on the capital costs of improvements to their customers, and that tiered rates must correspond to the actual cost of providing service at a given level of usage. East Valley Water District (District) conducted a thorough rate analysis that forms the basis for the new rate structure based on the three available sources of supply.

Effective June 1, East Valley Water District will implement a budget based rate billing program that provides each customer with a unique water budget. The new tiered rate structure was approved during the March 25 Public Hearing.

“Budget Based Rates are designed to meet each customer’s needs while incorporating necessary capital improvement projects essential for maintaining the water system,” said James Morales, Jr., Chairman of the District’s Board of Directors. “The recent ruling reinforces the process the District undertook in order to clearly show that each of our tiers has a direct connection to the cost of providing water to our customers.”

Since beginning the cost of service review process in early 2014, the District reached out to the community through public workshops, community meetings, website content, and a comprehensive public notice mailed to all property owners and residents. The District also formed a Rate Study Working Group to discuss budget based rates with customers, resulting in valuable feedback that was incorporated into the process.

“We provide water to our customers from three separate sources with three different costs associated with them,” said John Mura, District General Manager/CEO. “Our new budget based, tiered rate structure, allows for the most affordable water to be designated for indoor use, efficient outdoor use to be allocated the slightly higher cost of water, and inefficient water use allocated our most expensive source of supply.”

The District’s new rate structure has been designed to reflect the actual cost of providing water service while encouraging customers to conserve, consistent with Proposition 218 regulations. This industry best practice will increase the District’s ability to address drought challenges and continue providing a reliable supply of water for customers. In order to better understand how the Court’s decision related to East Valley Water District, legal counsel prepared an explanation of the court’s ruling (See Attachment A).

For more information on the new rate structure and the San Juan Capistrano Ruling, visit eastvalley.org/rates.

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East Valley Water District is a California Special District that provides water and wastewater services to 101,733 residents within the City of Highland and portions of both the City and County of San Bernardino. For more information please visit the District's website at www.eastvalley.org.



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Attachment A

Review of Capistrano Taxpayers Association v. City of San Juan Capistrano

A recent decision by the California Court of Appeal has shed some light on the requirements for water districts to implement tiered rate structures for the collection of water rates in compliance with Proposition 218. In *Capistrano Taxpayers Association v. City of San Juan Capistrano*, the 4th District Court of Appeals struck down a tiered water rate structure implemented by the City of San Juan Capistrano (City), ruling that the City's rates failed to accurately correspond with the City's actual costs of providing service to its ratepayers. However, the court explicitly upheld the validity of tiered water rates, simply issuing a narrow ruling confined to the specific, and seemingly arbitrary, rates implemented by the City in this case.

In *Capistrano Taxpayers Association v. City of San Juan Capistrano*, the ruling court expressed various concerns with the specific tiered rate structure adopted by the City. The City based its water rates on four separate service tiers. For residential customers, tier 1, the lowest tier, was assumed to be exclusively indoor usage, based on World Health Organization (WHO) guidelines concerning the "minimum quantity of water required for survival," with adjustments for things like "low-flush toilets and other high-efficiency appliances." Tier 2, the next tier, included an outdoor allocation based on "typical landscapes," and assumed "use of native plants and drought-tolerant plants." The final two tiers were based on budgets of what the City considered excessive usages of water or overuse volumes.

On appeal, the City was charged with tying its rates for the various tiers to the costs of providing water service to each tier. One particular issue the court had with the City's rate structure was the express tidiness of the tier differences. For example, the difference between Tier 1 and Tier 2 was a tidy $1/3$ extra, the difference between Tier 2 and 3 was a similarly exact $1/2$ extra, and the difference between Tier 3 and Tier 4 was precisely $5/6$ ths extra. This fractional precision suggested to the court that the City did not attempt to correlate its rates with cost of service. The court determined that such mathematical tidiness is rare in multi-decimal point calculations. This conclusion was later confirmed at oral argument in the court of appeal, when the City acknowledged it had not tried to correlate the incremental cost of providing service at the various incremental tier levels to the prices of water at those levels.

The City had obtained its water from five separate sources: a municipal groundwater recovery plant, the Metropolitan Water District, five local groundwater wells, recycled water wells, and the nearby Moulton Niguel Water District. With the exception of water obtained from the Metropolitan Water District, the City admitted in its briefing on the case that the record does not contain any breakdown as to the relative cost of each source of supply. The City also did not try to calculate the incremental cost of providing water at the level of use represented by each tier, and in fact, at oral argument in the court of appeal, admitted it effectively used revenues from the top tiers to subsidize below-cost rates for the bottom tier.

The court ruled that to comply with Proposition 218, which requires water rates be proportional to the costs of service, the City was required correlate its tiered prices with the actual cost of providing water at those tiered levels. The City never attempted to justify its price points as based on costs of service for those tiers. Rather, the City merely used what it thought was its legislative, discretionary power to attribute arbitrary percentages of total costs to the various tiers. The court even asked the City in supplemental briefing to show how its prices for various tiers corresponded with the actual costs of delivering service to those properties and the City responded that it didn't have to.



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The court ruled that while there is nothing at all in Proposition 218 that prevents water agencies from enacting tiered rate structures to pass on the incrementally higher costs of expensive water to incrementally higher users, the City had failed to adequately tie its bases for increases amongst the four tiers to the costs of serving those tiers. Thus, the City's rates were struck down.

East Valley Water District's recent implementation of tiered water rates can be contrasted from the rates struck down by the court of appeal in the *Capistrano* decision. As noted above, the *Capistrano* court's primary issues with the City's water rates were not that they were allocated based on tiers, but that the specific rates of each tier were not supported by the costs of providing water to each level of user. The City in *Capistrano* did not provide the specific costs of each of its sources of water. East Valley Water District did provide specific costs for each of its sources of water, on numerous occasions and during public workshops. Further, the City in *Capistrano* priced its four tiers at clean fractional intervals which were admittedly not based on the costs of obtaining water to meet the demands of the higher usage tiers. In contrast, East Valley Water District clearly presented the specific costs of its various water sources and based its tier pricing, to the cent, on the amounts of usage which would shift water users from one water source to the next. East Valley Water District then based the pricing of its tiers on the costs of providing water service based on the specific sources needed to meet the demand of a specific user. East Valley's rate structure falls in line with the *Capistrano* court's demands, as the court had urged the City to figure out the costs of given usage levels that require the City to tap into more expensive supplies, and then bill users in those tiers accordingly, to satisfy legal requirements. This is exactly what East Valley Water District has done with its tiered water rates.

While tiered, or inclined rates that go up progressively in relation to usage are perfectly consonant with California law, the tiers must still correspond to the actual cost of providing service at a given level of usage. The water agency in *Capistrano* did not try to calculate the cost of actually providing water at its various tier levels. East Valley Water District, through intense attention to detail, has structured its rates to correspond with its actual costs of providing water service to specific tiers based on the cost of supply. Thus the *Capistrano* decision supports East Valley Water District's tiered water rates.