



# San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233  
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

February 9, 2016

Randy Record

Members of the Board of Directors

Metropolitan Water District of Southern California

P.O. Box 54153

Los Angeles, CA 90054-0153

MEMBER AGENCIES

Carlsbad  
Municipal Water District

City of Del Mar

City of Escondido

City of National City

City of Oceanside

City of Poway

City of San Diego

Fallbrook  
Public Utility District

Helix Water District

Lakeside Water District

Olivenhain  
Municipal Water District

Otay Water District

Padre Dam  
Municipal Water District

Camp Pendleton  
Marine Corps Base

Rainbow  
Municipal Water District

Ramona  
Municipal Water District

Rincon del Diablo  
Municipal Water District

San Dieguito Water District

Santa Fe Irrigation District

South Bay Irrigation District

Vailcitos Water District

Valley Center  
Municipal Water District

Vista Irrigation District

Yuima  
Municipal Water District

OTHER  
REPRESENTATIVE

County of San Diego

RE: 2016 Rate Setting Process and Schedule for Public Hearing  
Request for Distribution of Cost of Service Report Prior to the Public Hearing

Dear Chairman Record and Members of the Board:

At yesterday's Finance and Insurance Committee meeting, the Chief Financial Officer, Gary Breaux, informed the Board that MWD's 2016 Cost of Service Report (which is the basis of its proposed 2017 and 2018 rates), will not be presented to the Board or made available to the public until the Board's planned Workshop #4, scheduled for March 22, 2016. **That is two weeks AFTER the public hearing on the proposed rates and just three weeks prior to the April 12 board meeting when the rates are proposed to be adopted.** This schedule gives the public NO time to review the Cost of Service Report prior to the public hearing, and severely limits the amount of time available for MWD's member agencies to review and analyze the Cost of Service Report, data and analysis.

In a Feb. 4 letter (attached) to Dawn Chin, Clerk of the Board, the Water Authority formally requested "...all of the data and proposed methodology MWD will rely upon for establishing rates, charges, surcharges, surcharges or fees for 2017 and 2018... in accordance with Government Code Section 54999.7 (d) and (e), which necessarily includes its cost of service report. This law requires MWD to provide *all* of this data no later than 30 days before rates and charges are adopted. The planned March 22 release of the cost of service report does not comply with this requirement. While MWD's general counsel has previously contended in correspondence, and MWD contended in court that it is not required to comply with Government Code Section 54999.7, Judge Karnow specifically ruled 54999.7 applies to MWD.

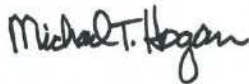
Aside from the law requiring MWD to make this information available in a timely fashion to affected public agencies such as the Water Authority (and the rest of MWD's customer member agencies), there is an even more fundamental concern with holding a public hearing on MWD's rates without making available to the public in advance, the cost of service report explaining

how MWD has allocated its costs and is proposing to set its rates.

How can the public intelligently comment on rates, when the basis for setting those rates has not been made available? Conducting a public hearing without providing the most basic information explaining the proposed action by the Board not only lacks transparency, but frustrates the very purpose of having a public hearing to obtain input on legislative decisions in matters of public policy.

As noted in our February 6, 2016 letter (attached), the Cost of Service Report and analysis has historically been made available to the Board and public at the same time as the proposed budget, in January or February of each year, thus allowing a meaningful time for review. We object to this new schedule and ask that either the Cost of Service Report be made available at least 30-days prior to the scheduled public hearing, or, that the public hearing and rate-setting schedule be adjusted to allow at least 30 days for review by all affected public agencies and members of the public.

Sincerely,



Michael T. Hogan  
Director



Keith Lewinger  
Director



Fern Steiner  
Director



Yen C. Tu  
Director

Attachment 1: Water Authority Acting General Counsel's February 4, 2016 letter RE Request for Data and Proposed Methodology for Establishing Rates and Charges

Attachment 2: Water Authority Delegates' February 6, 2016 letter RE Board Memo 9-2



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Municipal Water District

February 4, 2016

**Dawn Chin**  
**Clerk of the Board**  
**Metropolitan Water District of Southern California**  
**P.O. Box 54153**  
**Los Angeles, CA 90054-0153**

**Re: Written Request for Notice (Government Code Section 54999.7(d));**  
**Request for Data and Proposed Methodology for Establishing Rates and Charges**  
**(Government Code Section 54999.7(e))**

Dear Ms. Chin:

The San Diego County Water Authority hereby requests notice of the public meetings and to be provided with all of the data and proposed methodology MWD will rely upon for establishing rates, charges, surcharges or fees for 2017 and 2018 (and any other years that may be before the board during the current rate cycle) in accordance with Government Code Section 54999.7(d) and (e).

Please contact me if you have any questions.

Sincerely,

**James J. Taylor**  
**Acting General Counsel**

**cc: Maureen Stapleton, SDCWA General Manager**  
**Jeffrey Kightlinger, MWD General Manager**  
**Marcia Scully, MWD General Counsel**

### OTHER REPRESENTATIVE

County of San Diego



## San Diego County Water Authority

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February 6, 2016

Randy Record and

Members of the Board of Directors

Metropolitan Water District of Southern California

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Los Angeles, CA 90054-0153

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### OTHER REPRESENTATIVE

County of San Diego

RE: Board Memo 9-2: Proposed biennial budget and revenue requirements for fiscal years 2016/17 and 2017/18; estimated water rates and charges for calendar years 2017 and 2018 to meet revenue requirements; and ten-year forecast

Dear Chairman Record and Board Members:

The purpose of this letter is to provide preliminary comments and questions on Board Memo 9-2, proposed biennial budget and revenue requirements (collectively, the "Budget Document") in advance of the budget and rate workshops that begin with Monday's Finance and Insurance Committee meeting.

**1. The Budget Document lacks sufficient detail to understand how MWD has spent money or deliberate how MWD is proposing to spend money.** As one example, among many, MWD's proposed Demand Management cost summary does not identify any of the projects included in either Local Resources Program (\$43.7 and \$41.9 million, respectively for the respective fiscal years) or Future Supply Actions (\$4.4 and \$2 million, respectively). The budget also lacks projected actual expenditures for fiscal year (FY) 2016; instead, all comparisons are budget to budget. It is important for Board members to consider actual expenditures as well as proposed budgets, particularly in light of the very substantial additions and modifications to spending that occurred outside of the 2014 budget after it was adopted -- in the hundreds of millions of dollars. We request to be provided with greater detail explaining the proposed expenditures at a detail level sufficient to allow the Board to deliberate where savings might be achieved, as well as to understand the status or outcomes of past programs and expenditures.

**2. The Budget Document does not provide any cost of service analysis and lacks sufficient detail to understand how MWD's costs should be assigned to rates.** Different than past years, the current Budget Document **does not include any cost of service analysis**. Why has that not been provided? In addition, the Budget Document does not provide a sufficient level of detail or information in order for MWD to defend its rates and establish "**cost**

MWD Chairman Record and Members of the Board

February 6, 2016

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**causation**" in accordance with legal requirements. Using the Demand Management cost summary again as an example, it is impossible to identify the proportionate benefits to MWD's customer member agencies resulting from the proposed expenditures. Broad, unsupported statements, such as "demand management programs reduce reliance on imported water," and "demand management programs reduce demands and burdens on MWD's system," are legally insufficient to comply with the common law or California statutory or Constitutional requirements that require MWD to conform to cost of service.

While we understand that MWD has appealed Judge Karnow's decision in the rate cases filed by the Water Authority, there is an increasing body of case law reaffirming these requirements, and clearly establish that they are applicable to water suppliers such as MWD. As one example, we attach a copy of the recent decision of the court in *Newhall County Water District v. Castaic Lake Water Agency*, where a number of arguments by Castaic that are very similar to those made by MWD were again rejected by the Court of Appeal. Chief among them was the argument that the water wholesaler need only identify benefits to its customers "collectively," rather than in a manner that reflects a reasonable relationship to the customers' respective burdens on, or benefits received from the wholesale agency's activities and expenditures. Contrary to these clear legal requirements, MWD's current Budget Document does not provide sufficient information to allow Board members or MWD's 26 customer member agencies to determine proportionate benefit from MWD's proposed expenditures. We repeat here for these purposes, our request to be provided with a greater level of detail regarding MWD's proposed spending, as well as the basis upon which MWD has assessed or may assess proportionate benefit to its customers. We also believe the Board would benefit from a public presentation on current and developing case law regarding the applicability of Proposition 26 to wholesale water agencies such as MWD, so that it is informed of its legal obligations as Board members in setting rates.

**3. *The Budget Document does not provide any analysis or data to explain or support the wide range of variation in proposed increases and decreases in various rate categories.*** The budget describes an "overall rate increase of 4%;" however, that is a meaningless number outside of the context of specific rates and charges as applied to MWD's 26 customer member agencies, which depends on the type of service or water they buy and what they pay in fixed charges. ***The following rate increases and decreases are proposed for each of the respective fiscal years, without any data or analysis to explain them:***

- Tier 1 supply rate increases of 28.8% and 4%;
- Wheeling rate increases of 6.2% and 4.5%;
- Treatment surcharge decrease of 10.1%, followed by an increase of 2.2%;
- Full service untreated rate increases of 12.1% and 4.4%;
- Full service treated rate increases of 3.9% and 3.7%;
- Readiness-to-Serve (RTS) charge decreases of 11.8% and 3.7%; and
- Capacity Charge (CC) decrease of 26.6%, followed by an increase of 8.8%.

There is no demonstration in the Budget Document that MWD's expenses recovered by the RTS

MWD Chairman Record and Members of the Board

February 6, 2016

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and CC will vary to such a degree in FYs 2017 and 2018 to support the very substantial proposed decreases in those fixed charges. Moreover, these sources of fixed cost recovery are being reduced at the very same time MWD is proposing to add fixed treatment cost recovery and suspend the property tax limitation under Section 124.5. In addition to the inconsistent logic, MWD is reducing the very charges authorized by the Legislature in 1984 so MWD could have more fixed revenue in lieu of its reliance on property taxes. MWD's proposed rates are precisely contrary to the intent of Sections 124.5 and 134 of its Act (copies attached). We ask that the General Counsel provide a legal opinion why MWD's actions are not the opposite of what was intended by passage of these provisions of the MWD Act.

Absent a justification that is not apparent from the Budget Document, these proposed rate increases and decreases appear to be arbitrary and unreasonable. We ask for the Board's support to require staff to provide both *data and analysis* to support these proposed rates and charges so that they may be understood and demonstrated to be based on cost causation principles.

**4. *The Budget Document mischaracterizes the Board's PAYGo funding policy and past actions; and is now proposing a "Resolution of Reimbursement" to formally authorize use of PAYGo revenues to pay for O&M, if necessary.*** The Board's PAYGo funding policy was historically set at 20 percent. See attached excerpt from the Board's July 8, 2013 Finance and Insurance Committee meeting. However, MWD staff has for the last several years been using PAYGo funds on an "as- and how-needed" basis. The Board has never deliberated or set a PAYGo "target" or "policy" at 60 percent. Moreover, contrary to what is stated in the Budget Document, the 2014 budget included CIP PAYGo funding at 100 percent, with the 2014 ten-year forecast stating that it "anticipates funding 100% of the CIP from PAYG and Replacement and Refurbishment (R&R) funds for the first three fiscal years, then transitioning to funding 60% of the CIP from water sales revenues." The absence of a Board policy being applied consistently not only fails to accomplish the purpose of PAYGo funding -- to equitably distribute costs of the CIP over time -- but exposes MWD to further litigation risk as funds that are collected for one purpose (CIP) are used for a different purpose (O&M).

The Board should not adopt the recommended "Resolution of Reimbursement" authorizing staff in advance to collect \$120 million annually for one purpose (CIP) and potentially use it for another (O&M). This is not only an unsound fiscal strategy, it serves to mask the true condition of MWD's budget and finances, and breaks any possible connection to cost of service. The Board should make a decision now on whether to raise rates, plan to borrow money or, notably at this point in the budget process, *reduce costs* (see also discussion of sales projections, below). The General Manager has told the Board (during its discussion of unbudgeted turf removal spending last year) that a 7 percent rate increase is necessary to support \$100 million in spending. Advance approval and use of PAYGo funds for O&M is nothing more than a hidden, de facto 8.4 percent additional rate increase each year.

MWD Chairman Record and Members of the Board  
 February 6, 2016  
 Page 4

**5. *The 1.7 MAF MWD sales estimate for the next two fiscal years is likely too high and if so, will leave the Board with an even larger revenue gap to fill; and the Budget Document lacks a fiscally sound contingency plan.*** The sales estimate may be too high given MWD's current trend at 1.63 MAF (a "sales" number that (at best) misleadingly includes the Water Authority's wheeled water) and El Nino conditions that make it unlikely that agencies will increase demand for MWD water. Further, while the board memo states the sales forecast accounts for 56,000 AF/year of new local supply from the Claude "Bud" Lewis Carlsbad Seawater Desalination Plant and Orange County Water District's expanded groundwater recycling project, no provision has been made for increased local supplies that may reasonably be projected to be available to the Los Angeles Department of Water and Power (LADWP). With a good year on the Eastern Sierra -- which is presently tracking the best snow pack on record -- MWD sales could be reduced by 250,000 AF or more, which translates to a negative revenue impact on MWD of between \$175 million and \$350 million.

It is MWD's obligation to forecast revenues responsibly, based on known and reasonably anticipated conditions, and plan for the contingency of reduced sales using responsible financial management techniques, which do not include budget gimmicks such as adoption of a "Resolution of Reimbursement" to shift CIP/PAYGo money to other uses.

We call to the Directors' attention that the proposed budget for FY 2017 already includes a revenue deficit of \$94.2 million, with MWD intending to withdraw from its reserves to bridge the gap. Similarly, the budget for fiscal year 2018 relies on \$23 million from reserves to fill the gap. Since sales may also be less than projected -- as they very well may be, for the reasons noted above -- the Board must plan now how the revenue gap will be filled. In this regard, we attach another copy of our November 17, 2014 letter suggesting the establishment of balancing accounts, allowing the Board to properly manage between good years and bad, rather than spending all of the money in good years (as it did this past year on turf removal) and needing to raise rates, borrow money or engage in the kind of gimmick represented by the Resolution of Reimbursement. We also ask that discussion of this issue be added to the next budget meeting agenda.

**6. *There is no demonstrated justification for suspension of the ad valorem tax limitation.*** As noted above, MWD is proposing in this budget to *reduce* the very charges the Legislature provided to MWD to be used in lieu of property taxes. Under these and other circumstances, there is no proper basis for MWD to suspend the tax rate limitation; instead, it should use the tools provided by the Legislature and included in the MWD Act.

**7. *No information is provided regarding the proposed changes in treatment cost recovery.*** Leaving aside the complete inconsistency with increasing fixed treatment cost recovery while reducing fixed cost recovery overall, when will the detail on the new charge be available?

MWD Chairman Record and Members of the Board

February 6, 2016

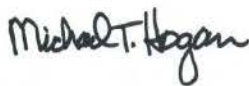
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**8. The Budget Document does not explain why MWD's debt service coverage ratios for 2017 and 2018 are dropping from 2x to 1.6x.** A comparison of the financial indices between this 2016 budget and the 2014 forecast shows a difference of only 50,000 AF of water sales reduction each year, yet the debt service ratios are plummeting from 2x to 1.6x. This drop is potentially very disturbing based on the aggressive water supply development plans MWD staff included in the IRP (and upon which it stated that spending decisions would be proposed and made). This is an important issue and policy discussion the Board must address.

**9. The CIP numbers contained in the Budget Document don't match the Appendix.** The Budget Document includes annual CIP expenditures of \$200 million for each of the proposed fiscal years; however the CIP Appendix includes expenditures of \$246 million and \$240 million, respectively, for fiscal years 2017 and 2018. Please explain and correct the discrepancy by increasing the budget number or reducing projects contained in the Appendices. We will have more extensive comments going forward, and in particular, once additional detail is provided as requested in this letter.

We look forward to beginning the budget review process next week and engaging in a productive dialog with our fellow directors.

Sincerely,



Michael T. Hogan  
Director



Keith Lewinger  
Director



Fern Steiner  
Director



Yen C. Tu  
Director

Attachment 1: Appellate Court Decision – *Newhall County Water District v. Castaic Lake Water Agency*

Attachment 2: Excerpt from the Board's July 8, 2013 Finance and Insurance Committee Meeting

Attachment 3: MWD Act Sections 124.5 and 134

Attachment 4: Water Authority's November 17, 2014 Letter RE Balancing Accounts



Filed 1/19/16

**CERTIFIED FOR PUBLICATION**

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION EIGHT

NEWHALL COUNTY WATER  
DISTRICT,

Plaintiff and Respondent,

v.

CASTAIC LAKE WATER AGENCY et  
al.,

Defendants and Appellants.

B257964

(Los Angeles County  
Super. Ct. No. BS142690)

APPEAL from a judgment of the Superior Court for the County of Los Angeles.  
James C. Chalfant, Judge. Affirmed.

Best Best & Krieger, Jeffrey V. Dunn, and Kimberly E. Hood for Defendants and  
Appellants.

Colantuono, Highsmith & Whatley, Michael G. Colantuono, David J. Ruderman,  
Jon R. di Cristina; Lagerlof, Senecal, Gosney & Kruse and Thomas S. Bunn III for  
Plaintiff and Respondent.

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**SUMMARY**

Plaintiff Newhall County Water District (Newhall), a retail water purveyor, challenged a wholesale water rate increase adopted in February 2013 by the board of directors of defendant Castaic Lake Water Agency (the Agency), a government entity responsible for providing imported water to the four retail water purveyors in the Santa Clarita Valley. The trial court found the Agency’s rates violated article XIII C of the California Constitution (Proposition 26). Proposition 26 defines any local government levy, charge or exaction as a tax requiring voter approval, unless (as relevant here) it is imposed “for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of providing the service or product.” (Cal. Const., art. XIII C, § 1, subd. (e)(2).)<sup>1</sup>

The challenged rates did not comply with this exception, the trial court concluded, because the Agency based its wholesale rate for imported water in substantial part on Newhall’s use of groundwater, which was not supplied by the Agency. Consequently, the wholesale water cost allocated to Newhall did not, as required, “bear a fair or reasonable relationship to [Newhall’s] burdens on, or benefits received from, the [Agency’s] activity.” (Art. XIII C, § 1, subd. (e), final par.)

We affirm the trial court’s judgment.

**FACTS**

We base our recitation of the facts in substantial part on the trial court’s lucid descriptions of the background facts and circumstances giving rise to this litigation.

**1. The Parties**

The Agency is a special district and public agency of the state established in 1962 as a wholesale water agency to provide imported water to the water purveyors in the Santa Clarita Valley. It is authorized to acquire water and water rights, and to provide, sell and deliver that water “at wholesale only” for municipal, industrial, domestic and

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<sup>1</sup> All further references to any “article” are to the California Constitution.

other purposes. (Wat. Code Appen., § 103-15.) The Agency supplies imported water, purchased primarily from the State Water Project, to four retail water purveyors, including Newhall.

Newhall is also a special district and public agency of the state. Newhall has served its customers for over 60 years, providing treated potable water to communities near Santa Clarita, primarily to single family residences. Newhall owns and operates distribution and transmission mains, reservoirs, booster pump stations, and 11 active groundwater wells.

Two of the other three retail water purveyors are owned or controlled by the Agency: Santa Clarita Water Division (owned and operated by the Agency) and Valencia Water Company (an investor-owned water utility controlled by the Agency since December 21, 2012). Through these two retailers, the Agency supplies about 83 percent of the water demand in the Santa Clarita Valley. The Agency's stated vision is to manage all water sales in the Santa Clarita Valley, both wholesale and retail.

The fourth retailer is Los Angeles County Waterworks District No. 36 (District 36), also a special district and public agency, operated by the County Department of Public Works. It is the smallest retailer, accounting for less than 2 percent of the total water demand.

**2. Water Sources**

The four retailers obtain the water they supply to consumers from two primary sources, local groundwater and the Agency's imported water.

The only groundwater source is the Santa Clara River Valley Groundwater Basin, East Subbasin (the Basin). The Basin is comprised of two aquifer systems, the Alluvium and the Saugus Formation. This groundwater supply alone cannot sustain the collective demand of the four retailers. (The Basin's operational yield is estimated at 37,500 to 55,000 acre-feet per year (AFY) in normal years, while total demand was projected at 72,343 AFY for 2015, and 121,877 AFY in 2050.)

The groundwater basin, so far as the record shows, is in good operating condition, with no long-term adverse effects from groundwater pumping. Such adverse effects

(known as overdraft) could occur if the amount of water extracted from an aquifer were to exceed the amount of water that recharges the aquifer over an extended period. The retailers have identified cooperative measures to be taken, if needed, to ensure sustained use of the aquifer. These include the continued “conjunctive use” of imported supplemental water and local groundwater supplies, to maximize water supply from the two sources. Diversity of supply is considered a key element of reliable water service during dry years as well as normal and wet years.

In 1997, four wells in the Saugus Formation were found to be contaminated with perchlorate, and in 2002 and 2005, perchlorate was detected in two wells in the Alluvium. All the wells were owned by the retailers, one of them by Newhall. During this period, Newhall and the two largest retailers (now owned or controlled by the Agency) increased their purchases of imported water significantly.

### **3. Use of Imported Water**

Until 1987, Newhall served its customers relying only on its groundwater rights.<sup>2</sup> Since 1987, it has supplemented its groundwater supplies with imported water from the Agency.

The amount of imported water Newhall purchases fluctuates from year to year. In the years before 1998, Newhall’s water purchases from the Agency averaged 11 percent of its water demand. During the period of perchlorate contamination (1998-2009), its imported water purchases increased to an average of 52 percent of its total demand. Since then, Newhall’s use of imported water dropped to 23 percent, and as of 2012,

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<sup>2</sup> Newhall has appropriative water rights that arise from California’s first-in-time-first-in-right allocation of limited groundwater supplies. (See *El Dorado Irrigation Dist. v. State Water Resources Control Board* (2006) 142 Cal.App.4th 937, 961 [“ ‘[T]he appropriation doctrine confers upon one who actually diverts and uses water the right to do so provided that the water is used for reasonable and beneficial uses and is surplus to that used by riparians or earlier appropriators.’ ”]; *City of Barstow v. Mojave Water Agency* (2000) 23 Cal.4th 1224, 1241 [“ ‘As between appropriators, . . . the one first in time is the first in right, and a prior appropriator is entitled to all the water he needs, up to the amount he has taken in the past, before a subsequent appropriator may take any [citation].’ ”].)

Newhall received about 25 percent of its total water supply from the Agency. The overall average since it began to purchase imported water in 1987, Newhall tells us, is 30 percent.

The other retailers, by contrast, rely more heavily on the Agency's imported water. Agency-owned Santa Clarita Water Division is required by statute to meet at least half of its water demand using imported water. (See Wat. Code Appen., § 103-15.1, subd. (d).) Agency-controlled Valencia Water Company also meets almost half its demand with imported water.

**4. The Agency's Related Powers and Duties**

As noted above, the Agency's primary source of imported water is the State Water Project. The Agency purchases that water under a contract with the Department of Water Resources. The Agency also acquires water under an acquisition agreement with the Buena Vista Water Storage District and the Rosedale-Rio Bravo Water Storage District, and other water sources include recycled water and water stored through groundwater banking agreements. Among the Agency's powers are the power to "[s]tore and recover water from groundwater basins" (Wat. Code Appen., § 103-15.2, subd. (b)), and "[t]o restrict the use of agency water during any emergency caused by drought, or other threatened or existing water shortage, and to prohibit the wastage of agency water" (§ 103-15, subd. (k)).

In addition, and as pertinent here, the Agency may "[d]evelop groundwater management plans within the agency which may include, without limitation, conservation, overdraft protection plans, and groundwater extraction charge plans . . . ." (Wat. Code Appen., § 103-15.2, subd. (c).) The Agency has the power to implement such plans "subject to the rights of property owners and with the approval of the retail water purveyors and other major extractors of over 100 acre-feet of water per year." (*Ibid.*)

In 2001, the Legislature required the Agency to begin preparation of a groundwater management plan, and provided for the formation of an advisory council consisting of representatives from the retail water purveyors and other major extractors.

(Wat. Code Appen., § 103-15.1, subd. (e)(1)&(2)(A).) The Legislature required the Agency to “regularly consult with the council regarding all aspects of the proposed groundwater management plan.” (*Id.*, subd. (e)(2)(A).)

Under this legislative authority, the Agency spearheaded preparation of the 2003 Groundwater Management Plan for the Basin, and more recently the 2010 Santa Clarita Valley Urban Water Management Plan. These plans were approved by the retailers, including Newhall.

The 2003 Groundwater Management Plan states the overall management objectives for the Basin as: (1) development of an integrated surface water, groundwater, and recycled water supply to meet existing and projected demands for municipal, agricultural and other water uses; (2) assessment of groundwater basin conditions “to determine a range of operational yield values that will make use of local groundwater conjunctively with [State Water Project] and recycled water to avoid groundwater overdraft”; (3) preservation of groundwater quality; and (4) preservation of interrelated surface water resources. The 2010 Santa Clarita Valley Urban Water Management Plan, as the trial court described it, is “an area-wide management planning tool that promotes active management of urban water demands and efficient water usage by looking to long-range planning to ensure adequate water supplies to serve existing customers and future demands . . . .”

**5. The Agency’s Wholesale Water Rates**

The board of directors of the Agency fixes its water rates, “so far as practicable, [to] result in revenues that will pay the operating expenses of the agency, . . . provide for the payment of the cost of water received by the agency under the State Water Plan, provide for repairs and depreciation of works, provide a reasonable surplus for improvements, extensions, and enlargements, pay the interest on any bonded debt, and provide a sinking or other fund for the payment of the principal of that bonded debt . . . .” (Wat. Code Appen., § 103-24, subd. (a).) The Agency’s operating costs include costs for management, administration, engineering, maintenance, water quality compliance, water resources, water treatment operations, storage and recovery programs, and studies.

Before the rate changes at issue here, the Agency had a “100 percent variable” rate structure. That means it charged on a per acre-foot basis for the imported water sold, known as a “volumetric” rate. Thus, as of January 1, 2012, retailers were charged \$487 per acre-foot of imported water, plus a \$20 per acre-foot charge for reserve funding.

Because of fluctuations in the demand for imported water (such as during the perchlorate contamination period), the Agency’s volumetric rates result in fluctuating, unstable revenues. The Agency engaged consultants to perform a comprehensive wholesale water rate study, and provide recommendations on rate structure options. The objective was a rate structure that would provide revenue sufficiency and stability to the Agency, provide cost equity and certainty to the retailers, and enhance conjunctive use of the sources of water supply and encourage conservation. As the Agency’s consultants put it, “[t]wo of the primary objectives of cost of service water rates are to ensure the utility has sufficient revenue to cover the costs of operating and maintaining the utility in a manner that will ensure long term sustainability and to ensure that costs are recovered from customers in a way that reflects the demands they place on the system.”

The general idea was a rate structure with both volumetric and fixed components. Wholesale rate structures that include both a fixed charge component (usually calculated to recover all or a portion of the agency’s fixed costs of operating, maintaining and delivering water) and a volumetric component (generally calculated based on the cost of purchased water, and sometimes including some of the fixed costs) are common in the industry.

## **6. The Challenged Rates**

The Agency’s consultants presented several rate structure options. In the end, the option the Agency chose (the challenged rates) consisted of two components. The first component is a fixed charge based on each retailer’s three-year rolling average of total water demand (that is, its demand for the Agency’s imported water *and* for groundwater not supplied by the Agency). This fixed charge is calculated by “divid[ing] the Agency’s total fixed revenue for the applicable fiscal year . . . by the previous three-year average of total water demand of the applicable Retail Purveyor to arrive at a unit cost per acre

foot.” The Agency would recover 80 percent of its costs through the fixed component of the challenged rates. The second component of the Agency’s rate is a variable charge, based on a per acre foot charge for imported water.<sup>3</sup>

The rationale for recovering the Agency’s fixed costs in proportion to the retailers’ total water demand, rather than their demand for imported water, is this (as described in the consultants’ study):

“This rate structure meets the Agency’s objective of promoting resource optimization, conjunctive use, and water conservation. Since the fixed cost is allocated on the basis of each retail purveyor’s total demand, if a retail purveyor conserves water, then its fixed charge will be reduced. Additionally, allocating the fixed costs based on total water demand recognizes that imported water is an important standby supply that is available to all retail purveyors, and is also a necessary supply to meet future water demand in the region, and that there is a direct nexus between groundwater availability and imported water use – i.e., it allocates the costs in a manner that bears a fair and reasonable relationship to the retail purveyors’ burdens on and benefits from the Agency’s activities in ensuring that there is sufficient water to meet the demands of all of the retail purveyors and that the supply sources are responsibly managed for the benefits of all of the retail purveyors.”

The rationale continues: “Moreover, the Agency has taken a leadership role in maintaining the health of the local groundwater basin by diversifying the Santa Clarita Valley’s water supply portfolio, as demonstrated in the 2003 Groundwater Management Plan and in resolving perchlorate contamination of the Saugus Formation aquifer. Thus, since all retail purveyors benefit from imported water and the Agency’s activities, they should pay for the reasonable fixed costs of the system in proportion to the demand (i.e.

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<sup>3</sup> There was also a \$20 per acre foot reserve charge to fund the Agency’s operating reserves, but the Agency reports in its opening brief that it suspended implementation of that charge as of July 1, 2013, when reserve fund goals were met earlier than anticipated.



burdens) they put on the total water supply regardless of how they utilize individual sources of supply.”

The Agency’s rate study showed that, during the first year of the challenged rates (starting July 1, 2013), Newhall would experience a 67 percent increase in Agency charges, while Agency controlled retailers Valencia Water Company and Santa Clarita Water Division would see reductions of 1.9 percent and 10 percent, respectively. District 36 would have a 0.8 percent increase. The rate study also indicated that, by 2050, the impact of the challenged rates on Newhall was expected to be less than under the then-current rate structure, while Valencia Water Company was expected to pay more.

Newhall opposed the challenged rates during the ratemaking process. Its consultant concluded the proposed structure was not consistent with industry standards; would provide a nonproportional, cross-subsidization of other retailers; and did not fairly or reasonably reflect the Agency’s costs to serve Newhall. Newhall contended the rates violated the California Constitution and other California law. It proposed a rate structure that would base the Agency’s fixed charge calculation on the annual demand for imported water placed on the Agency by each of its four customers, using a three-year rolling average of past water deliveries to each retailer.

In February 2013, the Agency’s board of directors adopted the challenged rates, effective July 1, 2013.

## **7. This Litigation**

Newhall sought a writ of mandate directing the Agency to rescind the rates, to refund payments made under protest, to refrain from charging Newhall for its imported water service “with respect to the volume of groundwater Newhall uses or other services [the Agency] does not provide Newhall,” and to adopt a new, lawful rate structure. Newhall contended the rates were not proportionate to Newhall’s benefits from, and burdens on, the Agency’s service, and were therefore invalid under Proposition 26, Proposition 13, Government Code section 54999.7, and the common law of utility ratemaking.

The trial court granted Newhall's petition, finding the rates violated Proposition 26. The court concluded the Agency had no authority to impose rates based on the use of groundwater that the Agency does not provide, and that conversely, Newhall's use of its groundwater rights does not burden the Agency's system for delivery of imported water. Thus the rates bore no reasonable relationship to Newhall's burden on, or benefit received from, the Agency's service. The trial court also found the rates violated Government Code section 54999.7 (providing that a fee for public utility service "shall not exceed the reasonable cost of providing the public utility service" (Gov. Code, § 54999.7, subd. (a)), and violated common law requiring utility charges to be fair, reasonable and proportionate to benefits received by ratepayers. The court ordered the Agency to revert to the rates previously in effect until the adoption of new lawful rates, and ordered it to refund to Newhall the difference between the monies paid under the challenged rates and the monies that would have been paid under the previous rates.

Judgment was entered on July 28, 2014, and the Agency filed a timely notice of appeal.

## DISCUSSION

The controlling issue in this case is whether the challenged rates are a tax or a fee under Proposition 26.

### 1. The Standard of Review

We review de novo the question whether the challenged rates comply with constitutional requirements. (*Griffith v. City of Santa Cruz* (2012) 207 Cal.App.4th 982, 989-990 (*Griffith I*.) We review the trial court's resolution of factual conflicts for substantial evidence. (*Morgan v. Imperial Irrigation District* (2014) 223 Cal.App.4th 892, 916.)

### 2. The Governing Principles

All taxes imposed by any local government are subject to voter approval. (Art. XIII C, § 2.) Proposition 26, adopted in 2010, expanded the definition of a tax. A "tax" now includes "any levy, charge, or exaction of any kind imposed by a local government,"

with seven exceptions. (*Id.*, § 1, subd. (e).) This case concerns one of those seven exceptions.

Under Proposition 26, the challenged rates are not a tax, and are not subject to voter approval, if they are “[a] charge imposed for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of providing the service or product.” (Art. XIII C, § 1, subd. (e)(2).) The Agency “bears the burden of proving by a preponderance of the evidence” that its charge “is not a tax, that the amount is no more than necessary to cover the reasonable costs of the governmental activity, and that the manner in which those costs are allocated to a payor bear a fair or reasonable relationship to the payor’s burdens on, or benefits received from, the governmental activity.” (*Id.*, subd. (e), final par.)

### **3. This Case**

It is undisputed that the Agency’s challenged rates are designed “to recover all of its fixed costs via a fixed charge,” and not to generate surplus revenue. Indeed, Newhall recognizes the Agency’s right to impose a fixed water-rate component to recover its fixed costs. The dispute here is whether the fixed rate component may be based in significant part on the purchaser’s use of a product – groundwater – not provided by the Agency.

We conclude the Agency cannot, consistent with Proposition 26, base its wholesale water rates on the retailers’ use of groundwater, because the Agency does not supply groundwater. Indeed, the Agency does not even have the statutory authority to regulate groundwater, without the consent of the retailers (and other major groundwater extractors). As a consequence, basing its water rates on groundwater it does not provide violates Proposition 26 on two fronts.

First, the rates violate Proposition 26 because the method of allocation does not “bear a fair or reasonable relationship to the payor’s burdens on, or benefits received from,” the Agency’s activity. (Art. XIII C, § 1, subd. (e), final par.) (We will refer to this as the reasonable cost allocation or proportionality requirement.)

Second, to the extent the Agency relies on its groundwater management activities to justify including groundwater use in its rate structure, the benefit to the retailers from those activities is at best indirect. Groundwater management activities are not a “service . . . provided directly to the payor that is not provided to those not charged” (art. XIII C, § 1, subd. (e)(2)), but rather activities that benefit the Basin as a whole, including other major groundwater extractors that are not charged for those services.

For both these reasons, the challenged rates cannot survive scrutiny under Proposition 26. The Agency resists this straightforward conclusion, proffering two principal arguments, melded together. The first is that the proportionality requirement is measured “collectively,” not by the burdens on or benefits received by the individual purveyor. The second is that the “government service or product” the Agency provides to the four water retailers consists not just of providing wholesale water, but also of “managing the Basin water supply,” including “management . . . of the Basin’s groundwater.” These responsibilities, the Agency argues, make it reasonable to set rates for its wholesale water service by “tak[ing] into account the entire Valley water supply portfolio and collective purveyor-benefits of promoting conjunctive use, not just the actual amount of Agency imported water purchased by each Purveyor . . . .”

Neither claim has merit, and the authorities the Agency cites do not support its contentions.

**a. *Griffin I* and the proportionality requirement**

It seems plain to us, as it did to the trial court, that the demand for a product the Agency does not supply – groundwater – cannot form the basis for a reasonable cost allocation method: one that is constitutionally required to be proportional to the benefits the rate payor receives from (or the burden it places on) the Agency’s activity. The Agency’s contention that it may include the demand for groundwater in its rate structure because the proportionality requirement is measured “collectively,” not by the burdens on or benefits to the individual retail purveyor, is not supported by any pertinent authority.

In contending otherwise, the Agency relies on, but misunderstands, *Griffith I* and other cases stating that proportionality “‘is not measured on an individual basis,’ ” but

rather “ ‘collectively, considering all rate payors,’ ” and “ ‘need not be finely calibrated to the precise benefit each individual fee payor might derive.’ ” (*Griffith I, supra*, 207 Cal.App.4th at p. 997, quoting *California Farm Bureau Federation v. State Water Resources Control Bd.* (2011) 51 Cal.4th 421, 438 [discussing regulatory fees under the Water Code and Proposition 13].) As discussed *post*, these cases do not apply here, for one or more reasons. *Griffith I* involves a different exemption from Proposition 26, and other cases involve Proposition 218, which predated Proposition 26 and has no direct application here. In addition to these distinctions – which do make a difference – the cases involved large numbers of payors, who could rationally be (and were) placed in different usage categories, justifying different fees for different classes of payors.

In *Griffith I*, the defendant city imposed an annual inspection fee for all residential rental properties in the city. The court rejected a claim that the inspection fee was a tax requiring voter approval under Proposition 26. (*Griffith I, supra*, 207 Cal.App.4th at p. 987.) *Griffith I* involves another of the seven exemptions in Proposition 26, the exemption for regulatory fees – charges imposed for the regulatory costs of issuing licenses, performing inspections, and the like. (Art. XIII C, § 1, subd. (e)(3) [expressly excepting, from the “tax” definition, a “charge imposed for the reasonable regulatory costs to a local government for . . . performing inspections”].)

The inspection fees in *Griffith I* met all the requirements of Proposition 26. The city’s evidence showed the fees did not exceed the approximate cost of the inspections. (*Griffith I, supra*, 207 Cal.App.4th at p. 997.) And the proportionality requirement of Proposition 26 was also met: “The fee schedule itself show[ed] the basis for the apportionment,” setting an annual registration fee plus a \$20 per unit fee, with lower fees for “[s]elf-certifications” that cost the city less to administer, and greater amounts charged when reinspections were required. (*Griffith I*, at p. 997.) The court concluded: “Considered collectively, the fees are reasonably related to the payors’ burden upon the inspection program. *The larger fees are imposed upon those whose properties require the most work.*” (*Ibid.*, italics added.)

*Griffith I* did, as the Agency tells us, state that “ ‘the question of proportionality is not measured on an individual basis’ ” but rather “ ‘collectively, considering all rate payors.’ ” (*Griffith I, supra*, 207 Cal.App.4th at p. 997.) But, as mentioned, *Griffith I* was considering a regulatory fee, not, as here, a charge imposed on four ratepayers for a “specific government service or product.” As *Griffith I* explained, “ ‘[t]he scope of a regulatory fee is somewhat flexible’ ” and “ ‘must be related to the overall cost of the governmental regulation,’ ” but “ ‘need not be finely calibrated to the precise benefit each individual fee payor might derive.’ ” (*Ibid.*) That, of course, makes perfect sense in the context of a regulatory fee applicable to numerous payors; indeed, it would be impossible to assess such fees based on the individual payor’s precise burden on the regulatory program. But the inspection fees *were* allocated by categories of payor, and were based on the burden on the inspection program, with higher fees where more city work was required.

Here, there are four payors, with no need to group them in classes to allocate costs. The *Griffith I* concept of measuring proportionality “collectively” simply does not apply. Where charges for a government service or product are to be allocated among only four payors, the only rational method of evaluating their burdens on, or benefits received from, the governmental activity, is individually, payor by payor. And that is particularly appropriate considering the nature of the Proposition 26 exemption in question: charges for a product or service that is (and is required to be) provided “directly to the payor.” Under these circumstances, allocation of costs “collectively,” when the product is provided directly to each of the four payors, cannot be, and is not, a “fair or reasonable” allocation method. (Art. XIII C, § 1, subd. (e), final par.)

**b. *Griffith II* – the proportionality requirement and related claims**

In *Griffith v. Pajaro Valley Water Management Agency* (2013) 220 Cal.App.4th 586 (*Griffith II*), the court concluded, among other things, that a groundwater augmentation charge complied with the proportionality requirement of Proposition 218. The Agency relies on *Griffith II*, asserting that the court applied the “concept of collective reasonableness with respect to rate allocations . . . .” Further, the case

demonstrates, the Agency tells us, that its activities in “management . . . of the Basin’s groundwater” justify basing its rates on total water demand, because all four retailers benefit from having the Agency’s imported water available, even when they do not use it. Neither claim withstands analysis.

*Griffith II* involved a challenge under Proposition 218, so we pause to describe its relevant points. Proposition 218 contains various procedural (notice, hearing, and voting) requirements for the imposition by local governments of fees and charges “upon a parcel or upon a person as an incident of property ownership, including a user fee or charge for a property related service.” (Art. XIII D, § 2, subd. (e).) Fees or charges for water service (at issue in *Griffith II*) are exempt from voter approval (art. XIII D, § 6, subd. (c)), but substantive requirements apply. These include a proportionality requirement: that the amount of a fee or charge imposed on any parcel or person “shall not exceed the proportional cost of the service attributable to the parcel.” (*Id.*, subd. (b)(3).)

In *Griffith II*, the plaintiffs challenged charges imposed by the defendant water management agency on the extraction of groundwater (called a “groundwater augmentation charge”). The defendant agency had been created to deal with the issue of groundwater being extracted faster than it is replenished by natural forces, leading to saltwater intrusion into the groundwater basin. (*Griffith II, supra*, 220 Cal.App.4th at p. 590.) The defendant agency was specifically empowered to levy groundwater augmentation charges on the extraction of groundwater from all extraction facilities, “ “for the purposes of paying the costs of purchasing, capturing, storing, and distributing supplemental water for use within [defendant’s boundaries].” ’ ” (*Id.* at p. 591.) The defendant’s strategy to do so had several facets, but its purpose was to reduce the amount of water taken from the groundwater basin by supplying water to some coastal users, with the cost borne by all users, “on the theory that even those taking water from [inland] wells benefit from the delivery of water to [coastal users], as that reduces the amount of groundwater those [coastal users] will extract [from their own wells], thereby keeping the water in [all] wells from becoming too salty.’ ” (*Id.* at pp. 590-591.)

*Griffith II* found the charge complied with the Proposition 218 requirement that the charge could not exceed the proportional costs of the service attributable to the parcel. (*Griffith II, supra*, 220 Cal.App.4th at pp. 600-601.) Proposition 218, the court concluded, did not require “a parcel-by-parcel proportionality analysis.” (*Griffith II*, at p. 601.) The court found defendant’s “method of grouping similar users together for the same augmentation rate and charging the users according to usage is a reasonable way to apportion the cost of service,” and Proposition 218 “does not require a more finely calibrated apportion.” (*Griffith II*, at p. 601.) The augmentation charge “affects those on whom it is imposed by burdening them with an expense they will bear proportionately to the amount of groundwater they extract at a rate depending on which of three rate classes applies. It is imposed ‘across-the-board’ on all water extractors. All persons extracting water – including any coastal users who choose to do so – will pay an augmentation charge per acre-foot extracted. All persons extracting water and paying the charge will benefit in the continued availability of usable groundwater.” (*Griffith II*, at pp. 603-604.)

The court rejected the plaintiffs’ claim the charge for groundwater extraction on their parcels was disproportionate because they did not use the agency’s services – that is, they did not receive delivered water, as coastal landowners did. This claim, the court said, was based on the erroneous premise that the agency’s only service was to deliver water to coastal landowners. The court pointed out that the defendant agency was created to manage the water resources for the common benefit of all water users, and the groundwater augmentation charge paid for the activities required to prepare and implement the groundwater management program. (*Griffith II, supra*, 220 Cal.App.4th at p. 600.) Further, the defendant agency “apportioned the augmentation charge among different categories of users (metered wells, unmetered wells, and wells within the delivered water zone).” (*Id.* at p. 601.) (The charges were highest for metered wells in the coastal zone, and there was also a per acre-foot charge for delivered water. (*Id.* at p. 593 & fn. 4.))

We see nothing in *Griffith II* that assists the Agency here. The Agency focuses on the fact that the defendant charged the plaintiff for groundwater extraction even though



the plaintiff received no delivered water, and on the court's statement that the defendant was created to manage water resources for the common benefit of all water users. (*Griffith II, supra*, 220 Cal.App.4th at p. 600.) From this the Agency leaps to the erroneous conclusion that the rates here satisfy the proportionality requirement simply because all four retailers "benefit from having the Agency's supplemental water supplies available," even when they do not use them. This is a false analogy. In *Griffith II*, the defendant charged all groundwater extractors proportionately for extracting water (and had the power to do so), and charged for delivered water as well. *Griffith II* does not support the imposition of charges based on a product the Agency does not supply.

We note further that in *Griffith II*, more than 1,900 parcel owners were subject to the groundwater augmentation charge, and they were placed in three different classes of water extractors and charged accordingly. (*Griffith II, supra*, 220 Cal.App.4th at pp. 593, 601.) Here, there are four water retailers receiving the Agency's wholesale water service, none of whom can reasonably be placed in a different class or category from the other three. In these circumstances, to say costs may be allocated to the four purveyors "collectively," based in significant part on groundwater not supplied by the Agency, because "they all benefit" from the availability of supplemental water supplies, would effectively remove the proportionality requirement from Proposition 26.

That we may not do. Proposition 26 requires by its terms an allocation method that bears a reasonable relationship to the payor's burdens on or benefits from the Agency's activity, which here consists of wholesale water service to be provided "directly to the payor." In the context of wholesale water rates to four water agencies, this necessarily requires evaluation on a "purveyor by purveyor" basis. (Cf. *Capistrano Taxpayers Assn., Inc. v. City of San Juan Capistrano* (2015) 235 Cal.App.4th 1493, 1514 (*Capistrano*) ["[w]hen read in context, *Griffith [II]* does not excuse water agencies from ascertaining the true costs of supplying water to various tiers of usage"; *Griffith II*'s "comments on proportionality necessarily relate only to variations in property location"; "trying to apply [*Griffith II*] to the [Proposition 218 proportionality] issue[] is fatally flawed".])

The Agency's claim that it is not charging the retailers for groundwater use, and its attempt to support basing its rates on total water demand by likening itself to the defendant agency in *Griffith II*, both fail as well. The first defies reason. Because the rates are based on total water demand, the more groundwater a retailer uses, the more it pays under the challenged rates. The use of groundwater demand in the rate structure necessarily means that, in effect, the Agency is charging for groundwater use.

The second assertion is equally mistaken. The differences between the Agency and the defendant in *Griffith II* are patent. In *Griffith II*, the defendant agency was created to manage all water resources, and specifically to deal with saltwater intrusion into the groundwater basin. The Agency here was not. It was created to acquire water and to "provide, sell, and deliver" it. It is authorized to develop and implement groundwater management plans only with the approval of the retail water purveyors (and other major groundwater extractors). In other words, while the Agency functions as the lead agency in developing and coordinating groundwater management plans, its only authority over groundwater, as the trial court found, is a shared responsibility to develop those plans. Further, in *Griffith II*, the defendant agency was specifically empowered to levy groundwater extraction charges for the purpose of purchasing supplemental water. The Agency here was not. As the trial court here aptly concluded, *Griffith II* "does not aid [the Agency] for the simple reason that [the Agency] has no comprehensive authority to manage the water resources of the local groundwater basin and levy charges related to groundwater."<sup>4</sup>

Finally, the Agency insists that it "must be allowed to re-coup its cost of service," and that the practice of setting rates to recover fixed expenses, "irrespective of a customer's actual consumption," was approved in *Paland v. Brooktrails Township*

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<sup>4</sup> The trial court also observed that, "[a]part from [the Agency's] lack of authority to supply or manage Basin groundwater, Newhall correctly notes that [the Agency] has presented no evidence of its costs in maintaining the Basin."

*Community Services Dist. Bd. of Directors* (2009) 179 Cal.App.4th 1358 (*Paland*).

*Paland* has no application here.

*Paland* involved Proposition 218. As we have discussed, Proposition 218 governs (among other things) “property related fees and charges” on parcels of property. Among its prohibitions is any fee or charge for a service “unless that service is actually used by, or immediately available to, the owner of the property in question.” (Art. XIII D, § 6, subd. (b)(4).) The court held that a minimum charge, imposed on parcels of property with connections to the district’s utility systems, for the basic cost of providing water service, regardless of actual use, was “a charge for an immediately available property-related water or sewer service” within the meaning of Proposition 218, and not an assessment requiring voter approval. (*Paland, supra*, 179 Cal.App.4th at p. 1362; see *id.* at p. 1371 [“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 [the plaintiff’s].”].)

We see no pertinent analogy between *Paland* and this case. This case does not involve a minimum charge imposed on all parcels of property (or a minimum charge for standing ready to supply imported water). Newhall does not contest the Agency’s right to charge for its costs of standing ready to provide supplemental water, and to recoup all its fixed costs. The question is whether the Agency may recoup those costs using a cost allocation method founded on the demand for groundwater the Agency does not supply, and is not empowered to regulate without the consent of groundwater extractors. The answer under Proposition 26 is clear: it may not. *Paland* does not suggest otherwise.<sup>5</sup>

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<sup>5</sup> The parties refer to other recent authorities to support their positions in this case. We may not rely on one of them, because the Supreme Court has granted a petition for review. (*City of San Buenaventura v. United Water Conservation District* (2015) 235 Cal.App.4th 228, review granted June 24, 2015, S226036.) The Agency cites the other case extensively in its reply brief, but we see nothing in that case to suggest that the challenged rates here comply with Proposition 26. (*Great Oaks Water Co. v. Santa Clara Valley Water District* 242 Cal.App.4th 1187 (*Great Oaks*).)

**c. Other claims – conservation and “conjunctive use”**

The Agency attempts to justify the challenged rates by relying on the conservation mandate in the California Constitution, pointing out it has a constitutional obligation to encourage water conservation. (Art. X, § 2 [declaring the state’s water resources must “be put to beneficial use to the fullest extent of which they are capable, and that the waste or unreasonable use or unreasonable method of use of water [must] be prevented”].) The challenged rates comply with this mandate, the Agency contends, because reducing total water consumption will result in lower charges, and the rates encourage “a coordinated use of groundwater and supplemental water” (conjunctive use). This argument, too, misses the mark.

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The Agency’s brief fails to describe the circumstances in *Great Oaks*. There, a water retailer challenged a groundwater extraction fee imposed by the defendant water district. Unlike this case, the defendant in *Great Oaks* was authorized by statute to impose such fees, and its major responsibilities included “preventing depletion of the aquifers from which [the water retailer] extracts the water it sells.” (*Great Oaks, supra*, 242 Cal.App.4th at p. 1197.) The Court of Appeal, reversing a judgment for the plaintiff, held (among other things) that the fee was a property-related charge, and therefore subject to some of the constraints of Proposition 218, but was also a charge for water service, and thus exempt from the requirement of voter ratification. (*Great Oaks*, at p. 1197.) The trial court’s ruling in *Great Oaks* did not address the plaintiff’s contentions that the groundwater extraction charge violated three substantive limitations of Proposition 218, and the Court of Appeal ruled that one of those contentions (that the defendant charged more than was required to provide the property related service on which the charge was predicated) could be revisited on remand. The others were not preserved in the plaintiff’s presuit claim, so no monetary relief could be predicated on those theories. (*Great Oaks*, at pp. 1224, 1232-1234.)

The Agency cites *Great Oaks* repeatedly, principally for the statements that the “provision of alternative supplies of water serves the long-term interests of extractors by reducing demands on the groundwater basin and helping to prevent its depletion,” and that it was not irrational for the defendant water district “to conclude that reduced demands on groundwater supplies benefit retailers by preserving the commodity on which their long-term viability, if not survival, may depend.” (*Great Oaks, supra*, 242 Cal.App.4th at pp. 1248-1249.) These statements, with which we do not disagree, have no bearing on this case, and were made in connection with the court’s holding that the trial court erred in finding the groundwater extraction charge violated the statute that created and empowered the defendant water district. (*Id.* at pp. 1252-1253.)

Certainly the Agency may structure its rates to encourage conservation of the imported water it supplies. (Wat. Code, § 375, subd. (a) [public entities supplying water at wholesale or retail may “adopt and enforce a water conservation program to reduce the quantity of water used by [its customers] for the purpose of conserving the water supplies of the public entity”]. But the Agency has no authority to set rates to encourage conservation of groundwater it does not supply. Moreover, article X’s conservation mandate cannot be read to eliminate Proposition 26’s proportionality requirement. (See *City of Palmdale v. Palmdale Water District* (2011) 198 Cal.App.4th 926, 936-937 [“California Constitution, article X, section 2 is not at odds with article XIII D [Proposition 218] so long as, for example, conservation is attained in a manner that ‘shall not exceed the proportional cost of the service attributable to the parcel.’ ”]; see *id.* at p. 928 [district failed to prove its water rate structure complied with the proportionality requirement of Proposition 218]; see also *Capistrano, supra*, 235 Cal.App.4th at p. 1511, quoting *City of Palmdale* with approval.)

The Agency also insists that basing its rates only on the demand for the imported water it actually supplies – as has long been the case – would “discourage users from employing conjunctive use . . . .” The Agency does not explain how this is so, and we are constrained to note that, according to the Agency’s own 2003 Groundwater Management Plan, Newhall and the other retailers “have been practicing the conjunctive use of imported surface water and local groundwater” for many years. And, according to that plan, the Agency and retailers have “a historical and ongoing working relationship . . . to manage water supplies to effectively meet water demands within the available yields of imported surface water and local groundwater.”

In connection, we assume, with its conjunctive use rationale, the Agency filed a request for judicial notice, along with its reply brief. It asked us to take notice of three documents and “the facts therein concerning imported water use and local groundwater production” by Newhall and the other water retailers. The documents are the 2014 and 2015 Water Quality Reports for the Santa Clarita Valley, and a water supply utilization table from the 2014 Santa Clarita Valley Water Report published in June 2015. All of

these, the Agency tells us, are records prepared by the Agency and the four retailers, after the administrative record in this case was prepared. The documents “provide further support” as to the “cooperative efforts of the Agency and the Purveyors in satisfying long-term water supply needs,” and “provide context and useful background to aid in the Court’s understanding of this case.” The Agency refers to these documents in its reply brief, pointing out that since 2011, Newhall has increased its imported water purchases because of the impact of the current drought on certain of its wells, while retailer Valencia Water Company increased groundwater pumping and purchased less imported water in 2014. These cooperative efforts, the Agency says, “reflect the direct benefit to Newhall of having an imported water supply available to it, whether or not it maximizes use of imported water in a particular year.”

We deny the Agency’s request for judicial notice. We see no reason to depart from the general rule that courts may not consider evidence not contained in the administrative record. (*Western States Petroleum Assn. v. Superior Court* (1995) 9 Cal.4th 559, 564; cf. *id.* at p. 578 [the exception to the rule in administrative proceedings, for evidence that could not have been produced at the hearing through the exercise of reasonable diligence, applies in “rare instances” where the evidence in question existed at the time of the decision, or in other “unusual circumstances”].) Denial is particularly appropriate where judicial notice has been requested in support of a reply brief to which the opposing party has no opportunity to respond, and where the material is, as the Agency admits, “further support” of evidence in the record, providing “context and useful background.” These are not unusual circumstances.

Returning to the point, neither conservation mandates nor the Agency’s desire to promote conjunctive use – an objective apparently shared by the retailers – permits the Agency to charge rates that do not comply with Proposition 26 requirements. Using demand for groundwater the agency does not supply to allocate its fixed costs may “satisf[y] the Agency’s constitutional obligations . . . to encourage water conservation,”

but it does not satisfy Proposition 26, and it therefore cannot stand.<sup>6</sup> (Cf. *Capistrano*, *supra*, 235 Cal.App.4th at pp. 1511, 1498 [conservation is to be attained in a manner not exceeding the proportional cost of service attributable to the parcel under Proposition 218; the agency failed to show its tiered rates complied with that requirement].)

**d. Other Proposition 26 requirements**

We have focused on the failure of the challenged rates to comply with the proportionality requirement of Proposition 26. But the rates do not withstand scrutiny for another reason as well. Proposition 26 exempts the Agency’s charges from voter approval only if the charge is imposed “for a specific government service or product provided *directly* to the payor that is *not* provided to those not charged . . . .” (Italics added.) The only “specific government service or product” the Agency provides directly to the retailers, and not to others, is imported water. As the trial court found: the Agency “does not provide Newhall groundwater. It does not maintain or recharge aquifers. It does not help Newhall pump groundwater. Nor does it otherwise contribute directly to the natural recharge of the groundwater Newhall obtains from its wells.”

The groundwater management activities the Agency *does* provide – such as its leadership role in creating groundwater management plans and its perchlorate remediation efforts – are not specific services the Agency provides directly to the retailers, and not to other groundwater extractors in the Basin. On the contrary, groundwater management services redound to the benefit of all groundwater extractors in the Basin – not just the four retailers. Indeed, implementation of any groundwater

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<sup>6</sup> The Agency also cites *Brydon v. East Bay Municipal Utility District* (1994) 24 Cal.App.4th 178 for the principle that, in pursuing a constitutionally and statutorily mandated conservation program, “cost allocations . . . are to be judged by a standard of reasonableness with some flexibility permitted to account for system-wide complexity.” (*Id.* at p. 193.) But *Brydon* predated both Proposition 218 and Proposition 26. (See *Capistrano*, *supra*, 235 Cal.App.4th at pp. 1512-1513 [*Brydon* “simply has no application to post-Proposition 218 cases”; “it seems safe to say that *Brydon* itself was part of the general case law which the enactors of Proposition 218 wanted replaced with stricter controls on local government discretion”].)

management plan is “subject to the rights of property owners and with the approval of the retail water purveyors *and other major extractors* of over 100 acre-feet of water per year.” (Wat. Code Appen., § 103-15.2, subds. (b)&(c), italics added.)

Certainly the Agency may recover through its water rates its entire cost of service – that is undisputed. The only question is whether those costs may be allocated, consistent with Proposition 26, based in substantial part on groundwater use. They may not, because the Agency’s groundwater management activities plainly are not a service “that is not provided to those not charged . . . .” (Art. XIII C, § 1, subd. (e)(2).)

In light of our conclusion the challenged rates violate Proposition 26, we need not consider the Agency’s contention that the rates comply with Government Code section 54999.7 and the common law. Nor need we consider the propriety of the remedy the trial court granted, as the Agency raises no claim of error on that point.

**DISPOSITION**

The judgment is affirmed. Plaintiff shall recover its costs on appeal.

GRIMES, J.

WE CONCUR:

BIGELOW, P. J.

FLIER, J.



## Transcription

Keith Lewinger (Director, San Diego County Water Authority)  
Tom DeBacker (Controller, Metropolitan Water District of Southern California)

### 3b: Financial highlights

#### Finance and Insurance Committee Meeting

July 8, 2013

**DeBacker** (16:53): That was not based on a percentage. There was a point in time when we did use a percentage and that percentage was about 20 percent of the CIP. When we changed from that practice we went to a 95 million dollars and that was just to kind of, you know, get us close to what a 20 percent amount would be, but it was not precisely 20 percent.

**Lewinger**: So it was meant to represent approximately 20 percent?

**DeBacker**: Yeah and I was just using that going forward.

# **The Metropolitan Water District Act**

## **PREFACE**

This volume constitutes an annotated version of the Metropolitan Water District Act, as reenacted by the California State Legislature in 1969 and as amended in 1970, 1971, 1972, 1973, 1974, 1975, 1976, 1978, 1981, 1984, 1985, 1995, 1998, 1999, 2001, 2004, and **2008**. Where there is no legislative history given for a section of this act, it is because the section was enacted as part of the nonsubstantive revision of the Metropolitan Water District Act, Statutes 1969, chapter 209. The editorial work was done by the office of the General Counsel of The Metropolitan Water District of Southern California. To facilitate use of the act, catchlines or catchwords enclosed by brackets have been inserted to indicate the nature of the sections which follow. Also, a table of contents has been set at the beginning of the act. Such table of contents and catchlines or catchwords are not a part of the act as enacted by the Legislature. This annotated act will be kept up to date by means of supplemental pages issued each year in which there is a change to the act.

**(Statutes 1969, ch.209, as amended;  
West's California Water Code – Appendix Section 109  
Deering's California Water Code – Uncodified Act 570)**

A contract between the State and a metropolitan water district for a water supply from the State Water Resources Development System was a contract for the furnishing of continued water service in the future, payments by the district being contingent upon performance of contractual duties by the State and not incurred at the outset, so the district did not incur an indebtedness in excess of that permitted by former Section 5(7) of the Metropolitan Water District Act (now Sec. 123).

*Metropolitan Water District v. Marquardt*, 59 Cal.2d 159, 28 Cal. Rptr. 724 (1963).

#### **Sec. 124. [Taxes, Levy and Limitation]**

A district may levy and collect taxes on all property within the district for the purposes of carrying on the operations and paying the obligations of the district, except that such taxes, exclusive of any tax levied to meet the bonded indebtedness of such district and the interest thereon, exclusive of any tax levied to meet any obligation to the United States of America or to any board, department or agency thereof, and exclusive of any tax levied to meet any obligation to the state pursuant to Section 11652 of the Water Code, shall not exceed five cents (\$0.05) on each such one hundred dollars (\$100) of assessed valuation. The term "tax levied to meet the bonded indebtedness of such district and the interest thereon" as used in this section shall also include, but shall not be limited to, any tax levied pursuant to Section 287 to pay the principal of, or interest on, bond anticipation notes and any tax levied under the provisions of any resolution or ordinance providing for the issuance of bonds of the district to pay, as the same shall become due, the principal of any term bonds which under the provisions of such resolution or ordinance are to be paid and retired by call or purchase before maturity with moneys set aside for that purpose.

Amended by Stats. 1969, ch. 441.

#### CASE NOTE

An article in a contract between the State and a metropolitan water district for a water supply from the State Water Resources Development System which article is based upon Water Code Section 11652, requiring the district to levy a tax to provide for all payments due under the contract, does not contravene former Section 5(8) of the Metropolitan Water District Act, imposing a limit on taxation, as Section 11652 is a special provision relating only to taxation to meet obligations from water contracts with state agencies, whereas said Section 5(8) is a general provision relating to taxation by a district for all purposes and the special provision controls the general provision.

*Metropolitan Water District v. Marquardt*, 59 Cal.2d 159, 28 Cal. Rptr. 724 (1963).

#### **Sec. 124.5. [Ad valorem Tax Limitation]**

Subject only to the exception in this section and notwithstanding any other provision of law, commencing with the 1990-91 fiscal year any ad valorem property tax levied by a district on taxable property in the district, other than special taxes levied and collected pursuant to annexation proceedings pursuant to Articles 1 (commencing with Section 350), 2 (commencing with Section 360), 3 (commencing with Section 370), and 6 (commencing with Section 405) of Chapter 1 of Part 7, shall not exceed the composite amount required to pay (1) the principal and interest on general obligation bonded indebtedness of the district and (2) that portion of the district's payment obligation under a water service contract with the state which is reasonably

allocable, as determined by the district, to the payment by the state of principal and interest on bonds issued pursuant to the California Water Resources Development Bond Act as of the effective date of this section and used to finance construction of facilities for the benefit of the district. The restrictions contained in this section do not apply if the board of directors of the district, following a hearing held to consider that issue, finds that a tax in excess of these restrictions is essential to the fiscal integrity of the district, and written notice of the hearing is filed with the offices of the Speaker of the Assembly and the President pro Tempore of the Senate at least 10 days prior to that date of the hearing.

Added by Stats. 1984, ch. 271.

### **Sec. 125. [Investment of Surplus Money]**

Investment of surplus moneys of a district is governed by Article 1 (commencing with Section 53600) of Chapter 4, Part 1, Division 2, Title 5 of the Government Code.

Amended by Stats. 1969, ch. 441.

### **Sec. 125.5 Guidelines for intended use of unreserved fund balances.**

On or before June 20, 2002, the board of directors of a district shall adopt a resolution establishing guidelines for the intended use of unreserved fund balances. The guidelines shall require that any disbursement of funds to member public agencies that represents a refund of money paid for the purchases of water shall be distributed based upon each member agency's purchase of water from the district during the previous fiscal year.

Added Stats. 2001 ch 632 §1 (SB350)

### **Sec. 126. [Dissemination of Information]**

A district may disseminate information concerning the activities of the district, and whenever it shall be found by two-thirds vote of the board to be necessary for the protection of district rights and properties, the district may disseminate information concerning such rights and properties, and concerning matters which, in the judgment of the board, may adversely affect such rights and properties. Expenditures during any fiscal year for the purposes of this section shall not exceed one-half of one cent (\$0.005) for each one hundred dollars (\$100) of assessed valuation of the district.

### **Sec. 126.5.[Proscription on Use of Public Money for Investigations Relating to Elected Officials, Advocacy Groups, or Interested Persons: Right to Public Records]**

(a) The Metropolitan Water District of Southern California and its member public agencies may not expend any public money for contracting with any private entity or person to undertake research or investigations with regard to the personal backgrounds or the statements of

board to be equitable, may fix rates for the sale and delivery to member public agencies of water obtained by the district from one source of supply in substitution for water obtained by the district from another and different source of supply, and may charge for such substitute water at the rate fixed for the water for which it is so substituted.

**Sec. 134. [Adequacy of Water Rates; Uniformity of Rates]**

The Board, so far as practicable, shall fix such rate or rates for water as will result in revenue which, together with revenue from any water stand-by or availability service charge or assessment, will pay the operating expenses of the district, provide for repairs and maintenance, provide for payment of the purchase price or other charges for property or services or other rights acquired by the district, and provide for the payment of the interest and principal of the bonded debt subject to the applicable provisions of this act authorizing the issuance and retirement of the bonds. Those rates, subject to the provisions of this chapter, shall be uniform for like classes of service throughout the district.

Amended by Stats. 1984, ch. 271

**Sec. 134.5. [Water Standby or Availability of Service Charge]**

(a) The board may, from time to time, impose a water standby or availability service charge within a district. The amount of revenue to be raised by the service charge shall be as determined by the board.

(b) Allocation of the service charge among member public agencies shall be in accordance with a method established by ordinance or resolution of the board. Factors that may be considered include, but are not limited to, historical water deliveries by a district; projected water service demands by member public agencies of a district; contracted water service demands by member public agencies of a district; service connection capacity; acreage; property parcels; population, and assessed valuation, or a combination thereof.

(c) The service charge may be collected from the member public agencies of a district. As an alternative, a district may impose a service charge as a standby charge against individual parcels within the district.

In implementing this alternative, a district may exercise the powers of a county water district under Section 31031 of the Water Code, except that, notwithstanding Section 31031 of the Water Code, a district may (1) raise the standby charge rate above ten dollars (\$10) per year by a majority vote of the board, and (2) after taking into account the factors specified in subdivision (b), fix different standby charge rates for parcels situated within different member public agencies.



## San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233  
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

November 17, 2014

Brett Barbre and  
Members of the Board of Directors  
Metropolitan Water District of Southern California  
P.O. Box 54153  
Los Angeles, CA 90054-0153

#### MEMBER AGENCIES

Carlsbad  
Municipal Water District  
City of Del Mar  
City of Escondido  
City of National City  
City of Oceanside  
City of Poway  
City of San Diego  
Fallbrook  
Public Utility District  
Helix Water District  
Lakeside Water District  
Olivienhain  
Municipal Water District  
Otay Water District  
Padre Dam  
Municipal Water District  
Camp Pendleton  
Marine Corps Base  
Rainbow  
Municipal Water District  
Ramona  
Municipal Water District  
Rincon del Diablo  
Municipal Water District  
San Dieguito Water District  
Santa Fe Irrigation District  
South Bay Irrigation District  
Vallecitos Water District  
Valley Center  
Municipal Water District  
Vista Irrigation District  
Yuima  
Municipal Water District  
OTHER  
REPRESENTATIVE  
County of San Diego

RE: Finance and Insurance Committee Item 6c – Balancing Accounts

Dear Committee Chair Barbre and Members of the Board:

Thank you for placing the balancing accounts issue on the committee agenda this month.

In September, when staff last presented the item for discussion, we noted that the content of the presentation was not responsive to the question, namely, how can revenues from individual rates be tracked to improve accountability and ensure compliance with cost-of-service requirements. We are disappointed to see that the same non-responsive staff presentation will be made again this month.

The concept of balancing accounts is well-known and easy to understand. It is a long-standing accounting practice among private water utilities used to protect both the utility and its customers from changes in costs the utility has no ability to control (for example, the weather,) and at the same time, ensure that rates accurately reflect the costs of providing service. Because MWD now derives significant revenues from transportation services, it is imperative that MWD's accounting methods ensure all of its member agencies and ratepayers that the rates they are paying are fair, and used for the intended purpose as established during the public rate-setting and cost-of-service process.

We are asking that MWD implement an accounting mechanism that tracks revenues from all individual rates and expenditures associated with those rates. To the extent that MWD actual sales differ from forecasted sales, it may collect more or less than the revenue requirement upon which the rate for a particular service is determined. Discrepancies between revenue requirements and actual revenues and expenses are captured through balancing account mechanisms, which "true-up" the actual revenue to the revenue requirement in the following year. This "true-up" ensures that MWD only collects the revenue requirement for the rate that is charged in compliance with applicable law.

We do not understand why MWD would be unwilling to extend its current practice of tracking

*A public agency providing a safe and reliable water supply to the San Diego region*

Committee Chair Barbre and Members of the Board

November 17, 2014

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treatment and water stewardship rates to also include supply, system access and system power rates. We are asking only that MWD account for all of its rates just as it now does for its treatment and water stewardship rates. Tracking rates and revenue collection in this manner does not impede MWD's ability to meet bond covenants or any other requirement or function described in the staff presentation.

We are also concerned with the position expressed at the last committee meeting that the Water Rate Stabilization Fund (WRSF) requirements should flow into a single fund with board discretion to expend those funds on any purpose. The melding of surplus funds received from different rates and charges would necessarily lead to cross-funding of unrelated services. Furthermore, the priority for fund flows (dollars in/out) could first be to the separate fund accounts for each identified service, rather than flowing first to the WRSF, as is the current practice, or sub-account funds could be created within the WRSF to track and account for sources of the "puts" into the WRSF and the "takes" from the fund. This would ensure collections from the rate for each service are accounted for and attributed to that service. Surplus collections remaining in that account may then be used to mitigate corresponding rate increases in the following years so funds are spent for that service in accordance with cost-of-service and Proposition 26 (2010) requirements.

We look forward to discussing this important transparency issue at the committee and board meeting this month.

Sincerely,



Michael T. Hogan  
Director



Keith Lewinger  
Director



Fern Steiner  
Director



Yen C. Tu  
Director