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METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

May 17, 1993

(Special Committee on Financial Policy--
Information)
(Finance and Insurance Committee--Information)
(Water Problems Committee--Information)

To: Board of Directors

From: General Manager and General Counsel

Subject: Connection Fees and Capacity Charges

Report

The Special Committee on Financial Policy has asked the General Counsel's office to confirm the status of current law regarding connection fees, capacity charges and related charges.

"Connection fee" and "connection charge" have been used to describe various types of charges for connection to or use of the capacity of a utility facility, because such fees are generally imposed as a condition to connection to the utility. However, statutes authorizing the imposition of connection fees, capacity charges and capital facilities fees distinguish between the cost of the physical connection to the utility facilities (a true "connection fee") and charges for use of capacity of the system.

Under the California Government Code, "water connection" is defined as the connection of a building to a public water system. A "water connection" fee is therefore simply the cost for connection of a building to the water system. "Capacity charges" are defined as charges for facilities which are of benefit to the person or property being charged; these charges may be for facilities in existence at the time the charges are imposed or charges for new facilities to be constructed in the future.

A "capital facilities fee" or "capacity charge" means any "non-discriminatory" charge to pay the capital cost of a public utility facility, including a facility for the provision of water. This definition uses the term "capital facilities fee" interchangeably with "capacity charge." A non-discriminatory charge is defined as a fee which does not exceed the proportionate share of the cost of the utility facilities which are of benefit to the person or property being charged, based upon the proportionate share of use of those facilities.

Authorization. Before it may impose a connection fee or capacity charge, Metropolitan must be specifically authorized by the Legislature to do so. The Metropolitan Water District Act contains no specific authorization to impose connection fees or capacity charges. However, Section 54999.2 of the Government Code provides, "Any public agency providing public utility service on or after July 21, 1986, may continue to charge, or may increase, an existing capital facilities fee, or may impose a new capital facilities fee after that date, and any public agency receiving a public utility's service shall pay those fees. . . ." (Emphasis added.)

This legislation was enacted following the decision of the California Supreme Court in San Marcos Water District v. San Marcos Unified School District (1986) 42 Cal.3d 154, which held that a school district was not required to pay a sewer capacity fee imposed as a condition to connecting the school district to the sewer system. The new law was intended to reverse this decision, to prevent public utilities from being impaired in their ability to collect facilities fees previously imposed on public users of utilities and to finance future facilities. This statute enables any public utility to impose new capital facilities fees on other public agencies.

Because of the narrow situation which it addressed, this law enables Metropolitan only to impose charges on other public agencies. No other statutory provisions currently grant Metropolitan the power to levy capacity charges or connection fees. Assembly Bill 842, introduced by Assembly Member Frazee, would authorize "any entity that does not have the power granted in its principal act" to impose and collect water capacity or connection charges for services and facilities furnished in connection with its public water system. "Public water system" is defined by reference to the Water Code and probably includes Metropolitan, despite the fact that Metropolitan does not provide water directly to the public.

Unless this or similar legislation is adopted, Metropolitan does not have authority to impose or collect connection fees or to impose capacity charges/capital facilities fees on retail customers. Metropolitan does, however, have the authority under Government Code section 54999.2 to impose capital facilities fees on its member agencies.

Limitations on Fees. Section 66013(a) of the Government Code states:

"Notwithstanding any other provision of law, when a local agency imposes fees for water connections or sewer connections, or imposes capacity charges, those fees or charges shall not exceed the estimated reasonable cost of providing the service for which the fee or charge is imposed, unless a question regarding the amount of the fee or charge imposed in excess of the estimated reasonable cost of providing the services or materials is submitted to, and approved by, a popular vote of two-thirds of those electors voting on the issue."

This statute codifies California case law, which holds that connection fees must be reasonably related in amount to the cost of services or facilities provided in exchange for those fees. In Guy S. Atkinson Co. v. Highland Park Public Utility District (1958) 158 Cal.App.2d 718, the court invalidated a connection fee which far exceeded the cost of labor and materials "actually expended and reasonably necessary" to connect a house to the water mains.

In Beaumont Investors v. Beaumont-Cherry Valley Water District (1985) 165 Cal.App.3d 227, the court concluded that the water district imposing a facilities fee did not sustain its burden of proof that the fee did not exceed the reasonable value of the services for which it was collected. The court therefore invalidated the fee because it was in effect a special tax levied without the two-thirds voter approval required for imposition of a special tax.

Fees Imposed on Development. The burden of proving that fees are not in excess of the costs for which they are imposed is particularly significant when a fee is imposed as a condition to new development. In Nollan v. California Coastal Commission (1987) 483 U.S. 825, the U.S. Supreme Court found the Coastal Commission's requirement that a property owner provide a beach access easement across his property as a condition to remodeling a beach house was an unconstitutional taking of property without just compensation. The court sought, and failed to find, the "essential nexus" between the condition and the purpose of the building restriction, and decreed that "unless the permit condition serves the same governmental purpose as the development ban, the building restriction is not a valid regulation of land use."

Section 66000 et seq. of the Government Code was chaptered on September 22, 1987, just three months after publication of the Nollan decision, and applies its principles to connection fees and capacity charges. Section 66001 lists a number of requirements applicable to a local agency which establishes, increases or imposes a fee as a condition of a development project. These requirements include specific findings to be made by the local agency with respect to such fees, as well as specific procedures for the segregation and handling of proceeds of such fees after they are imposed.

The local agency must identify the purpose of the fee and the use of the fee, determine how there is a reasonable relationship between the fee's use and the type of development project on which the fee is imposed, and find a reasonable relationship between the need for the facility and the type of development project. The local agency also must determine how there is reasonable relationship between the amount of the fee and cost of the public facility or the portion of the public facility attributable to the development on which the fee is imposed.

Based on cases interpreting these requirements, Metropolitan's practice of generating, commissioning from consultants and continually amending plans for system improvements to meet increased usage of water because of projected population growth in its service area would probably satisfy legal requirements for establishing the reasonableness of and "nexus" between the fees and proposed facilities. One key factor is the allocation of projected improvement costs between existing users and "growth", a practice already incorporated by Metropolitan in its planning process. Failure to make this allocation was the basis for invalidating a portion of school fees imposed on residential development in one recent case.

Fees for Existing Users. Capacity charges can be imposed based on increasing use of existing facilities by existing users. The sewer capacity charge examined in San Marcos, for example, consisted of a one-time charge based on the student and teacher population at each school, plus additional charges to be imposed on an annual basis as a school's population, and therefore its need for sewer capacity, increased.

Metropolitan could likewise charge each member agency for its respective proportionate share of the cost of system additions and improvements required to provide increased capacity as each member agency's need for water

increases. Such increased need for capacity could be demonstrated by peak water use of the member agency in a current period, compared to a baseline level, or some other method which demonstrates current capacity used by each member agency and measures the need for increased capacity. The increased capacity of Metropolitan's system then could be allocated among the member agencies and each agency would bear its proportionate share of the cost of these improvements.

Capacity Charges Compared to Water Rates, Standby and Availability Service Charges. Under Section 133 of the Metropolitan Water District Act, the Board is required to fix the rates at which water will be sold. Such rates "shall be uniform for like classes of service throughout the district." (Act, §134.)

Capacity charges and connection fees are not water rates. They are based on the proportionate cost of improvements to be utilized by the person or property on which the charge is imposed whether or not any water is used. Moreover, because these connection fees and capacity charges must be proportional to the cost of the portion of the facilities used or to be used by the party paying the fee, they are tailored to the usage of each such party. Imposing the current uniformity requirement for water rates to capacity charges or connection fees could destroy proportionality, resulting in potential invalidation of the connection fees or capacity charges.

Capacity charges and connection fees also are not standby or availability of service charges. Because the California Attorney General has opined that Metropolitan may not simultaneously impose both its current standby charge and an availability of service charge, it is important to distinguish capacity charges from such a service charge.

Standby charges or charges for the availability of water service "are fees exacted for the benefit which accrues by virtue of having water available to [a property], even though the water might not actually be used at the present time." (Kennedy v. Ukiah (1977) 69 Cal.App.3d 545, 553.) These charges, when assessed against individual parcels, are akin to benefit assessments. The particular use to which a parcel has been devoted is not to be taken into account in determining benefit derived from improvements financed through a particular assessment; instead, benefit is to be measured by the benefit to be received if the property is devoted to any reasonable use.

In contrast, a capacity charge to be valid must be based on a much more direct showing of the exact amount of benefit which a user will derive from specific capital improvements. In order to calculate this benefit, the particular use or anticipated use of the property must be taken into account. Therefore, a capacity charge is distinct from a standby or availability of service charge and may be imposed while a standby charge is in effect.

The surcharge upheld in the Kennedy case in fact resembles a capacity charge using the number of units as a measure of the maximum capacity to be used in each multi-family apartment building. The charge was levied to cover actual capacity requirements, and not future benefits. Even where a connection fee or capacity charge is paid prior to occupancy, the fee must be related to anticipated actual demand of the unit on the water system, not merely generic benefits accruing to the property on which the unit is located as well as other properties which may have varying uses but which are within the same geographic area.

Board Committee Assignments

This letter is referred for information to:

The Special Committee on Financial Policy pursuant to its authority to study and make recommendation with regard to alternative rate structures and revenue sources;

The Finance and Insurance Committee pursuant to its authority to determine revenues to be obtained through sales of water, water standby or availability of service charges, and the levying of taxes; and

The Water Problems Committee pursuant to its authority to study, revise, and make recommendations with regard to the selling prices of water and conditions governing sales and exchanges of water.

Recommendation

For information only.


General Manager


N. Gregory Taylor