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REPORT TO THE HONORABLE MAYOR AND COUNCILMEMBERS

PROPOSED ADJUSTMENTS TO WATER RATES IN ACCORDANCE WITH THE WATER MEMORANDUM MODIFYING THE 2025 WATER COST OF SERVICE STUDY (STANTEC MEMO)

INTRODUCTION

On October 6, 2026, the Council of the City of San Diego will consider Item 330 Public Hearing to Proposed Adjustments to Water Rates in Accordance with the Water Memorandum Modifying the 2025 Water Cost of Service Study. The Office of the City Attorney provides the following legal and factual background information in relation to this item.

BACKGROUND

Plaintiffs Daniel Patz and Joan Chesner are the representative members of a certified class consisting of the City's single-family residential water customers that challenged the City's use of tiered water rates in the *Patz v. City of San Diego*, Case No. 37-2015-00023413-CU-MC-CTL (pending). On September 13, 2021, the trial court found the City's tiered water rates for single-family residential customers violated Article XIII D, section 6 of the California Constitution (Proposition 218) and entered judgment for the class.

On March 30, 2022, following a trial on damages, the trial court awarded $79,541,880 for overpayments from August 14, 2014, through March 31, 2022, which would increase by $643,750 each month until December 1, 2023, when the City adopted new rates. The City appealed that decision and on July 30, 2025, the Court of Appeal affirmed the trial court's judgment on liability under Proposition 218 and remanded the matter on damages to the trial court to allow the City to satisfy the refund award under California Government Code section 53758.5.[1] *Patz v. City of San Diego,* 113 Cal. App. 5th 225 (2025). On October 29, 2025, the California Supreme Court denied further review and allowed the Court of Appeal (Court) decision to stand.

[1] Cal. Gov't Code section 53758.5 allows local agencies to credit the amount of the award against the revenue requirement in the next cost of service proceeding rather than enforce the refund award as a money judgment. Because Cal. Gov't Code section 53758.5 became effective in 2024 while the *Patz* appeal was pending, the Court directed that the judgment be amended to follow the refund process.

SUMMARY OF *PATZ V. CITY OF SAN DIEGO*

Proposition 218 prohibits a property-related fee from exceeding the proportional cost of the service attributable to the parcel, and the government bears the burden of proving compliance. The Court of Appeal rejected the City's argument that it needed to show only a reasonable basis for its rates. The Court held that the City had to establish by substantial evidence that its rates were proportional to service costs attributable to the parcels.

The Court agreed the City was liable for several reasons. Foremost, it found that the City did not adequately support the "peaking factors" used to allocate higher costs to unique customer classes and to the tiers within the single-family customer class. The Court agreed with the trial court that the "City failed to point to any evidence in the record that shows these allocations were based upon actual calculations of cost of service for water to be provided to a particular parcel…" *Patz*, 113 Cal. App. 5th at 277 (internal quotations omitted). The City lacked time-of-use or comparable data showing that single-family customers' higher monthly consumption caused greater peak demand or correspondingly higher system-capacity costs. The evidence also showed that other customer classes contributed to peak demand but were charged class-specific uniform rates.

Additionally, the Court determined that the tier breakpoints reflected average-use assumptions rather than actual demonstrated differences in cost. The Court further found unsupported rate disparities because single-family residential customers paid substantially more at higher tiers than irrigation and other customers for the same water. Based on the evidence, the Court affirmed the trial court's judgment that the City failed to prove that its tiered rates were cost-proportional.

Finally, the Court upheld the damages calculation while remanding the matter to the trial court for refund methodology. Based on the trial court's order, as affirmed by the Court of Appeal, the City is obligated to adopt rates compliant with Proposition 218 by January 1, 2027.

SUMMARY OF SETTLEMENT TERMS

The Parties began settlement negotiations in March 2026 through mediation. As a result, the Parties accepted a proposal to resolve the outstanding liabilities for $40 million. The settlement was approved by the Council on August 25, 2026, by San Diego Resolution R-316919.

The settlement proposal requires the City to establish a $40 million common fund, paying $4 million within 14 days after preliminary approval and the remaining $36 million within 14 days after final approval. The fund covers class distributions, attorneys' fees and litigation expenses, administration costs, and taxes. Each named plaintiff may be awarded up to $7,500. All awards remain subject to court approval and are paid from the settlement fund.

The trial court preliminarily approved the settlement, and the settlement administrator recently sent notice of the settlement to class members. Class members have until November 12,

2026, to opt-out of or object to the class settlement. Following the class notification process, the trial court will decide whether to approve the settlement at a final approval hearing.

CONCLUSION

The Court's decision determined that the City failed to prove its tiered single-family residential water rates were proportional to the cost of service, resulting in approximately $79 million in liability along with monthly penalties of more than $600,000 through December 1, 2023, resulting in approximately $120 million in total liabilities. In lieu of this total liability, the preliminarily approved settlement would resolve the case for $40 million. The process for final approval is underway to allow class members to opt-out or object. Item 330 proposes rates designed to comply with the court order requiring adoption of Proposition 218 compliant rates by January 1, 2027.

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