MARK M. MERCER
DEPUTY CITY ATTORNEY

OFFICE OF
THE CITY ATTORNEY
CITY OF SAN DIEGO

Michael J. Aguirre
CITY ATTORNEY

1200 THIRD AVENUE, SUITE 1620
SAN DIEGO, CALIFORNIA 92101-4178
TELEPHONE (619) 236-6220
FAX (619) 236-7215

MEMORANDUM OF LAW

DATE: August 4, 2008

TO: Tom Haynes, Fiscal and Policy Analyst, Office of the Independent Budget Analyst

FROM: City Attorney

SUBJECT: Use of Rate Payer Fees for the Indirect Potable Reuse Study

INTRODUCTION

The City recently approved a series of water rate increases following the procedures set forth in Proposition 218. In calculating the increases, the City of San Diego Water Department [Department] ascertained the cost of providing water service and the cost of commodity in compliance with Proposition 218. At the time the Department calculated the water rate increases, the Department did not factor the indirect potable reuse study [IPR Study] into the cost of service.

Subsequent to the preparation of the rate increase, the City Council directed the Mayor to implement an IPR Study to start on July 1, 2008. You have asked whether rate payer fees may be used to fund an IPR Study even though the project was not listed or factored into the latest water rate case.

QUESTION PRESENTED

1. May water rate payer revenue be used to fund the IPR Study?

SHORT ANSWER

1. Yes, the may City use rate payer money to fund the IPR Study, as long as the City uses the revenue received from its pre-existing rates and not revenue designated for particular purposes under previous Proposition 218 rate increases.

ANALYSIS

In 1996, California voters adopted Proposition 218, which added articles XIII C and XIII D to the California Constitution. These amendments placed limitations and restrictions on the ability of local governments to impose or increase certain charges or fees based on real property or incident to the ownership of real property. Proposition 218 requires the City to follow special notice procedures prior to any water rate increase, and places limits on how local governments may expend rate payer revenue. *Richmond v. Shasta Community Services District*, 32 Cal. 4th 409 (2004). All water rate revenue must be spent according to the following restrictions:

> (1) Revenues derived from the fee or charge shall not exceed the funds required to provide the property related service.
>
> (2) Revenues derived from the fee or charge shall not be used for any purpose other than that for which the fee or charge was imposed.
>
> (3) The amount of a fee or charge imposed upon any parcel or person as an incident of property ownership shall not exceed the proportional cost of the service attributable to the parcel.
>
> (4) No fee or charge may be imposed for a service unless that service is actually used by, or immediately available to, the owner of the property in question. Fees or charges based on potential or future use of a service are not permitted. Standby charges, whether characterized as charges or assessments, shall be classified as assessments and shall not be imposed without compliance with Section 4.
>
> (5) No fee or charge may be imposed for general governmental services including, but not limited to, police, fire, ambulance or library services, where the service is available to the public at large in substantially the same manner as it is to property owners. Reliance by an agency on any parcel map, including, but not limited to, an assessor's parcel map, may be considered a significant factor in determining whether a fee or charge is imposed as an incident of property ownership for purposes of this article. In any legal action contesting the validity of a fee or charge, the burden shall be on the agency to demonstrate compliance with this article.

Cal. Const. art. XIII D, § 6(b).

In determining whether article XIII D section 6(b)(2) bars changing listed water projects after the cost of service has been calculated, we apply well-established principles of constitutional interpretation. "The literal language of enactments may be disregarded to avoid absurd results and to fulfill the apparent intent of the framers." *Amador Valley Joint Union High Sch. Dist.* v. *State Bd. of Equalization*, 22 Cal. 3d 208, 245 (1978). When interpreting a state proposition it is helpful to examine the ballot comments drafted by the proponents of the particular proposition. *Id.*; *Carter v. Seaboard Finance Co*., 33 Cal. 2d 564, 580-81 (1949); *People v. Ottey,* 5 Cal. 2d 714, 723 (1936), *overruled on other grounds by People v. Cook*, 33 Cal. 3d 714 (1936); *In re Quinn*, 35 Cal. App. 3d 473, 483 (1973), *disapproved on other grounds by State of California v. San Luis Obispo Sportsman's Assn.,* 22 Cal. 3d 440 (1978).

The Howard Jarvis Tax Association issued the following comment regarding article XIII D, sections 6(b)(1) and (2):

> Requirement 1 & 2 will prohibit the current practice of siphoning off fee revenue to supplement a city's general fund. This practice, sometimes known as charging an 'in lieu franchise fee,' currently occurs both in Los Angeles and Sacramento, as well as in many municipalities. However, 'cost of service' may also include reasonable overhead expenses as other items on a service bill which are necessary to provide service to the particular user. What is included in 'cost of service' will have to be determined on a case by case basis.

http://www.hjta.org/node/98.

By reading the official comments, it is clear that the proponents of Proposition 218 intended article XIII D, section 6(b)(2) to prohibit the practice of local government transferring rate payer money into its general fund and barring the practice of "an in lieu fee." This section was not intended to constrain local government's operation once its cost of service has been calculated. This section does not bar local governments from deviating from its cost of service calculation in response to changed market conditions or a change in operation priorities. Denying the Department's operational flexibility would not follow the purpose of this section and would allow absurd results to follow.

In our case, the Department has an obligation to secure and locate sources of potable water for its customers. The IPR Study seeks to determine whether indirect potable reuse may provide the Department with another source of potable water for all water rate payers. Since locating new sources of potable water is a part of the Department's operation, the Department may include the IPR Study in its cost of providing water service.

However, the Department should also take into consideration the public noticing requirements of Proposition 218 when spending rate payer revenue. Before raising water rates, the Department is required by law to send notice of the following:

> provide written notice by mail of the proposed fee or charge to the record owner of each identified parcel upon which the fee is proposed for imposition, the amount of the fee or charge proposed to be imposed upon each, the basis upon which the amount of the proposed fee or charge was calculated, *the reason for the fee or charge*, together with the time, date and location of the public hearing for the proposed fee or charge.

Cal. Const. art. XIII D, § 6(a)(1).

In February 2007, the Department sent notice to rate payers that a water rate increase was necessary to repair and replace water treatment facilities, pipes and reservoirs. The Department should be cautious of directing revenue attributable to the recent water rate increase to purposes other than those listed in the Proposition 218 notice. Such an approach may not meet the rate payers' expectations. Therefore, our office recommends that if the City decides to use rate payer money to fund the IPR Study that the City only use revenue from its pre-existing rates and not revenue attributable to any of the recent rate increases adopted pursuant to Proposition 218.

CONCLUSION

Since the IPR study is part of the cost of service, Proposition 218 does not bar the use of rate payer fees to fund the study. However, if the City elects to use rate payer money to fund the study, the City should use the revenue received from its pre-existing rates and not revenue designated for particular purposes under previous Proposition 218 rate increases. In the alternative, the City may create a new water rate increase incorporating the IPR study into the cost of service.

MICHAEL J. AGUIRRE, City Attorney

By
Mark M. Mercer
Deputy City Attorney

MMM:nda:mb
ML-2008-12