The Court of Appeal Holds Groundwater Augmentation Charges Fees for Water Services Under Proposition 218 and Provides Much-Needed Guidance on Several Related Issues

by Joseph M. Quinn & Adam W. Hofmann

Hanson Bridgett Public Agency Practice Group

HansonBridgett

A state appellate panel on Tuesday published a decision that gives local agencies much-needed guidance on the application of Proposition 218. In *Griffith v. Pajaro Valley Water Management Agency* (Oct. 15, 2013, H038087) ___ Cal.App.4th ___ (2013 Cal. App. LEXIS 822) (*Griffith*), the Sixth District Court of Appeal found that, under the measure, groundwater augmentation charges are fees for "water service" and therefore they are not subject to the voter-approval requirement. Further, the court confirmed that proper apportionment for property-related fees is measured not payer by payer, but collectively considering all ratepayers. The court also provided guidance on Proposition 218's other substantive limitations.

Background

Proposition 218

Voters enacted Proposition 218 in 1996, to close perceived loopholes in Proposition 13 and related laws.The measure amended the California Constitution to add Articles XIII C and XIII D. Article XIII C requires voter approval for local taxes. Article XIII D establishes substantive and procedural requirements for property-related fees and assessments. *Griffith* discussed the provisions related to property-related fees.

Under Article XIII D, an agency seeking to establish or increase a property-related fee must hold a properly-noticed public hearing on the proposal. If a majority of affected property owners do not protest, the agency may adopt the proposed fee, but only after submitting the proposal for a vote and obtaining approval from two-thirds of property owners. Certain kinds of fees, however, including fees for "water service," are expressly excepted from this voter-approval requirement.

Proposition 218 also establishes substantive limitations for property-related fees. Revenues may not exceed the funds required to provide the related service. Nor may those revenues be used for any purpose other than that for which the fee was imposed. The fee may not exceed the cost of the service attributable to

the property. The service for which the fee is imposed must be used by or immediately available to the property's owner. And no fee may be imposed for general government services, or services that are available to the public at large in the same manner they are available to paying property owners.

The Pajaro Valley Water Management Agency and the Challenged Groundwater Charges

The Pajaro Valley Water Management Agency is charged by statute with managing local groundwater supply. To achieve its mission, the Agency utilizes recycled wastewater, supplemental wells, captured storm water, and a coastal distribution system. The Agency funds its efforts, in part, through a groundwater augmentation charge.

In 2002, the Agency established an $80/acre foot charge, but several citizens lodged challenges on the grounds that the Agency had not complied with the notice, hearing, and voter-approval requirements of Proposition 218. The Agency increased the charge in 2003 and 2004, and these charges were also challenged. The challenges culminated in a published appellate decision, holding that the groundwater augmentation charges were property-related fees governed by Proposition 218. (*Pajaro Valley Water Management Agency v. Amrhein* (2007) 150 Cal.App.4th 1364, 1370.) At that time, the court did not determine whether the charges were fees for "water service," nor did the court address any questions regarding Proposition 218's substantive requirements as applied to groundwater charges. The parties then settled the underlying litigation.

In May 2010, the Agency began a process to establish new groundwater charges utilizing Proposition 218 procedures. The new charges were divided into three tiers, one for metered wells, one for unmetered wells, and one for wells in the delivered water zone. The Agency mailed affected property owners notice of a public hearing regarding the proposed charges and permitted them an opportunity to protest. No majority protest was received. The Agency then enacted the new charges.

Next, in June 2010, the Agency initiated an all-mail election on the charges, mailing ballots to property owners subject to the charge. Votes were weighted according to each property's anticipated financial obligation as measured by average groundwater use over the preceding five years. The weighted vote approved the proposed charge; absent weighting, the proposal would have failed.

Harold Griffith and Joseph Pendry each filed suit, challenging the charges on the grounds that they violated Proposition 218. The trial court ruled for the Agency, and the Court of Appeal affirmed.

The *Griffith* Decision and Its Implications for Local Agencies

The decision provides significant guidance on the application of Proposition 218 to local agency fees.

1. Groundwater fees that fund agency-wide water management are not subject to Proposition 218's voter-approval requirement.

Plaintiffs claimed the agency violated Proposition 218 by adopting the groundwater charges on the basis of a weighted vote. The court held that the groundwater augmentation charge was a fee for "water service," exempt from Proposition 218's voter-approval requirement. The court explained that "water service" under Proposition 218 included domestic water delivery, and the groundwater charge did "not differ materially 'from a charge on delivered water.'" Moreover, contrary to the plaintiffs' arguments, the Agency's "water service" included its entire system of water management, which helps ensure an ongoing, potable supply of groundwater in the watershed.

This holding is particularly important to groundwater agencies. Prior to *Griffith*, whether any charges other than retail rates qualified as fees for "water service" was an open question. Some authorities suggested that only retail rates were covered. Some agencies incurred the expense of an election to avoid a Proposition 218 challenge. Other agencies did not conduct elections, but faced legal challenges. Most agencies struggled with the issue. Now, agencies can have a measure of comfort that groundwater charges are, indeed, fees for "water service" and therefore it is not necessary to conduct an election on new or increased charges.

2. Proposition 218's notice-and-protest procedure only requires notice to record owners of property, not to tenants and others.

The plaintiffs also challenged the Agency's notice-and-protest procedure. They claimed that the Agency violated Proposition 218 by failing to give notice of the protest hearing to tenants and utility customers who indirectly pay the augmentation charges. The Court of Appeal rejected this argument, as well. It concluded that Proposition 218 only required notice to record owners of affected property.

This holding will help all agencies administer their property-related fees. Proposition 218 is ambiguous on who must receive notice. *Griffith* helps clarify that, regardless of who else may pay the fee, an agency need provide notice only to record owners.

3. Proposition 218 does not require parcel-by-parcel apportionment of service costs; reasonable service tiers are permitted.

The plaintiffs' also argued that the groundwater charges violated the substantive requirements of Proposition 218. Most importantly, they claimed that the Agency violated Proposition 218 by establishing a three-tiered charge structure, rather than determining the cost to provide service on a parcel-by-parcel basis. The court ruled that Proposition 218 does not require a parcel-by-parcel analysis of service costs. The court explained that the measure "prescribes no particular method for apportioning a fee or charge," and it was "reasonable" for the Agency to apportion its actual costs of service amongst ratepayers, grouping similar users together into rate tiers. "That there may be other methods favored by plaintiffs does not render [the Agency's] method unconstitutional."

Griffith's holding on this point may help resolve disputes experienced by many agencies. Payers often complain that based on the specific characteristics of their property or their use of the resource, they are paying more than their fair share. *Griffith* supports the notion that as long as costs are fairly allocated across customer classes, a property-related fee satisfies Proposition 218's apportionment requirement. It is worth noting that Proposition 218 establishes separate and arguably more stringent apportionment requirements for assessments. Agencies should be cautious in using *Griffith's* apportionment analysis in the assessment context.

4. Agencies may set charges based on a revenue-requirements model, so long as their projected revenue requirements are mission-based.

In a related argument, the plaintiffs challenged the method by which the Agency determined the amount of the charge. The Agency used a "revenue-requirements model," by which it calculated its total cost of chargeable activities, deducted revenues expected from other sources, and apportioned the remaining revenue requirement amongst service users. The court upheld this method, noting that the American Water Works Association Manual of Water Supply Practices and the Agency's rate-making consultant both recommended this approach to setting the charges.

For agencies that provide a broad, unitary service, such as water management, this holding will likely help resolve disputes regarding charge-setting methodology. Agencies may now employ revenue-requirements analysis with some assurance that it is generally consistent with Proposition 218's substantive requirements.

Conclusion

As appellate courts have observed, Proposition 218 is far from a model of clarity. Agencies will continue to struggle with the many and serious questions it raises. And they will continue to assess the risks and costs of proceeding one way or another. *Griffith*, though, provides substantial guidance on several issues and merits careful study.

For more information, please contact:

Joseph M. Quinn, *Partner*
415-995-5108
jquinn@hansonbridgett.com

Adam W. Hofmann, *Senior Counsel*
415-995-5819
ahofmann@hansonbridgett.com

SAN FRANCISCO
425 Market Street, 26th floor
San Francisco, CA 94105
TEL 415-777-3200
FAX 415-541-9366

NORTH BAY
Wood Island
80 E. Sir Francis Drake Blvd, Ste. 3E
Larkspur, CA 94939
TEL 415-925-8400
TEL 707-546-9000
FAX 415-925-8409

SACRAMENTO
500 Capitol Mall, Ste.1500
Sacramento, CA 95814
TEL 916-442-3333
FAX 916-442-2348

SILICON VALLEY
950 Tower Lane, Ste. 925
Foster City, CA 94404
TEL 650-349-4440
FAX 650-349-4443

EAST BAY
1676 No. California Blvd.
Suite 620
Walnut Creek, CA 94596
TEL 925-746-8460
FAX 925-746-8490