EXHIBIT 1-A

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TO: Chair Potter, Board Members & General Manager **DRAFT**

FROM: David C. Laredo, General Counsel

RE: Imposition of Rates and Charges for Water Services

This memo reviews the process and authority by which the Monterey Peninsula Water Management District may impose rates and fees for services, facilities or water it may furnish.

ISSUE

May the Monterey Peninsula Water Management District (MPWMD or District) impose rates and charges for services, facilities or water it may furnish, as well costs of operations and activities related to the provision of water delivered by others? If so, what processes and limitations may apply?

CONCLUSION

MPWMD is authorized to impose rates and charges for services, facilities or water it furnishes, as well for costs of activities related to the provision of water by others. Courts recognize water pricing may include management of water resources in addition to water delivery costs. Fees may reimburse all costs to provide water service, imposed either upon persons receiving water or upon the parcel on which water use occurs. The fee is not a tax or an assessment and is expressly allowed by the California Constitution as amended by Proposition 218. To create the fee, the District must conduct a public hearing on the proposed fee, after appropriate notice, and find that a majority protest was not filed by owners of identified parcels. The water fee, however, is not subject to voter approval requirements.

ANALYSIS

General Authority to Impose Fees, Charges, and Rates

The Monterey Peninsula Water Management District is authorized, by law, to impose rates and charges for services, facilities or water that it may furnish, as well costs of operations and activities related to the provision of water delivered by others. (Statutes of 1977, Chapter 527, found at West's Water Law Appendix Section 118-1, *et. seq.* (District Law), §326.) This

authority is augmented by numerous California statutes.[1]

Health and Safety Code (H&S) §5471 provides alternative authority and processes by which MPWMD may adopt fees for water service.[2] In 2004, the Supreme Court considered H&S §5471 in *Richmond Community Services District v. Shasta Comm. Serv. Dist.* (2004) 32 Cal.4th 409, 427. The court concluded the Legislature intended this provision "not be read as limiting the powers conferred on public entities by the laws under which they were organized." (*Id.* at 430.) The purpose "is to supplement rather than to limit a public agency's authority to impose charges for water or sewer services in connection with a water or sewerage system." (*Id.*)

Therefore, public agencies are not required to adopt water and sewer rates under §5471, by ordinance adopted by a two-third's vote of the governing body; rather, an agency may rely on other sources of power, such as District Law §326 identified above, to establish rates by resolution adopted by a majority of the membership of the District Board.

General Requirements of Proposition 218

On November 5, 1996, the California electorate approved Proposition 218, the self-titled "Right to Vote on Taxes Act." Proposition 218 added Articles XIIIC and XIIID to the California Constitution[3], and made numerous changes to local government finance law.[4] A fee or charge subject to Proposition 218 is a "levy other than an ad valorem tax, a special tax, or an assessment, imposed by an agency 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. XIIID, §2(e).)

Understanding the requirements of Proposition 218 requires careful application and distinction of the three separate financing tools: taxes, fees and assessments. Distinction among these tools can be difficult and depends on the context. (*See, e.g., Sinclair Paint Co. v. Bd. of Equal.* (1997) 15 Cal.4th 866, 874-875.) For example, taxes, assessments and property-related fees all may be imposed on property. (Art. XIIID, § 3.)

A tax is a monetary imposition of a governmental legislative body on persons or property for the purpose of raising revenue to support its activities.[5] (*People v. McCreery* (1868) 34 Cal.432; *Taylor v. Palmer* (1866) 31 Cal.240.) In general, taxes are imposed for revenue purposes, rather than in return for a specific benefit conferred or privilege granted. (*Sinclair Paint Co., supra.)*

Proposition 218 defines "assessment" as "any levy or charge upon real property by an agency for

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[1] See, e.g., Govt. Code §54314 (Revenue Bond Law of 1941), Govt. Code §66000(b) (AB 1600); Pub. Util. Code §210; Water Code §§20541, 34034; Pub. Res. Code §13015; H&S §4955.

[2] H&S §§5473 and 5473.10 allow MPWMD to set water charges by ordinance, and enable specific statutory collection remedies.

[3] All citations to Article XIIIC and XIIID shall refer to the California Constitution, unless otherwise provided.

[4] See, generally, League of California Cities' *Proposition 218 Implementation Guide.* The court in *McBrearty v. City of Brawley* (1997) 59 Cal.App.4th 1441 cited as authoritative the *Proposition 218 Implementation Guide.*

[5] Proposition 218 defines a "general tax" as any tax imposed for general government purposes. *See* Cal. Const., art. XIIIC, § 1(a). A "special tax" is defined as any tax imposed for specific purposes, including taxes imposed for specific purposes and placed into a general fund. *See* Cal. Const., art. XIIIC, § 1(d).

a special benefit conferred upon the real property." (Art. XIIID, § 2(b).) Unlike a property-related fee or charge, which may be imposed on persons, an assessment can be imposed only on property. The key feature that distinguishes an assessment from a tax, fee or charge is the existence of this special benefit.[6] Without identifying a special benefit, there can be no assessment. (*Richmond, supra; Ventura Group Ventures, Inc. v. Ventura Port Dist.* (2001) 24 Cal.4th 1089, 1106.)

A special assessment, sometimes called a "benefit assessment," is a charge generally levied upon parcels of real property to pay for benefits the parcels receive from local improvements. Benefit assessments must be distinguished from assessments that are in the nature of a charge for service imposed. In *San Marcos Water District v. San Marcos Unified School District* (1986) 42 Cal.3d 154, the California Supreme Court stated that an assessment to defray costs of future capital improvements from public agencies, absent specific statutory authority, were in the nature of special assessments regardless of whether the charge was assessed to all property owners in the district or was levied only on users. The court's test to determine whether a charge is actually an assessment is whether the "purpose" of the fee is to defray the cost of capital improvements. If so, the fee will be deemed a special assessment regardless of the form of the fee for purposes of determining whether a public agency is exempt. After the *San Marcos* decision, the Legislature adopted Government Code sections 54999 through 54999.6.

A fee, in contrast, is a rate or charge that reimburses a public entity for all costs related to a service rendered, in an amount limited to its expenses, and not levied on a regular or routine basis. It is imposed for the use of a commodity or service, or to mitigate the impact of the fee payer's activities on the community. A fee may be "imposed by an agency upon a parcel or upon a person as an incident of property ownership, including user charges for a property-related service." (Art. XIII D, § 2 (e).).

A fee is not a tax or an assessment (*Crawford v. Herringer* (1978) 85 Cal.App.3d 544, 550). Although it is generally distinguished from a tax based on the relationship between the fee and the amount of revenue required to provide the service or facility for which the fee is imposed, the substantive requirements of Article XIIID, § 6 have created a slightly different way of distinguishing taxes from property-related fees.[7] In fact, much of the Proposition 13 and Proposition 218 case law has developed in response to a fee payer's challenge that a fee is actually a tax. The MPWMD User Fee, in particular, had been collected for 28 years under the District's authority to impose rates, fees, and charges.

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[6] City Council of City of San Jose v. South (1983) 146 Cal.App.3d 320, 332; Solvang Mun. Improvement Dist. v. Board of Supervisors (1980) 112 Cal.App.3d 545; County of Fresno v. Malmstrom (1979) 94 Cal.App.3d 974, 984.

[7] Fees for service may be distinguished from "standby charges." Proposition 218 classifies standby charges as "assessments" which must be imposed in compliance with article XIIID, section 4. A standby charge (sometimes called a standby fee) is a compulsory charge levied upon real property within a predetermined district to defray in whole or in part the expense of providing, operating or maintaining public improvements. The charge is "exacted for the benefit which accrues to property by virtue of having water [or other public improvement] available to it, even though the water might not be used at the present time." *Kennedy v. City of Ukiah* (1977) 69 Cal.App.3d 545, 553.

Property-Related Fees and Charges

Proposition 218 creates a special subset of fees and charges for "property-related" services. "Fee" or "charge" means any levy imposed by an agency on a parcel or on a person "as an incident of property ownership, including user fees or charges for property-related services." (Art. XIIID, §2(e).) The phrase, "*including* a user fee or charge for a property related service," clarifies fees and charges are distinct from taxes or assessments. The word "including" is "'ordinarily a term of enlargement.'" (citations omitted)

The phrase "property related fees and charges" appears in the title of Article XIIID, Sections 6 and §6(c) (relating to voter approval), but is not defined. Proposition 218 does, however, define "Property ownership" to include tenancies of real property when tenants are directly liable to pay the assessment, fee, or charge in question. (Art. XIIID, §2(g).) "Property-related service" means a public service having a direct relationship to property ownership, such as sewer or water services. (Art. XIIID, §2(h); *Bighorn, supra)*

Proposition 218 provides the following: "Reliance by an agency on any parcel map, including but not limited to 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 [Cal. Const., art XIIID]." (Art. XIIID, §6(b)(5))[8]

The California Supreme Court initially construed the term "property-related fees" narrowly to include only fees that cannot be avoided other than by selling property.[9] This was modified in *Bighorn, supra*, when the court elevated dicta in *Richmond* to a holding and concluded that "a public water agency's charges for ongoing water delivery... are fees and charges within the meaning of [Cal Const] article XIII D." *Bighorn, supra.*[10]

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[8] *Apartment Ass'n of Los Angeles County, Inc. v. City of Los Angeles* (2001) 24 Cal.4th 830 (concluding city ordinance imposing inspection fee on apartment owners is not subject to Art. XIIID); *Howard Jarvis Taxpayers Ass'n v City of Fresno* (2005) 127 Cal.App.4th 914 (charter-authorized general fund transfer from water and sewer funds was prohibited by Proposition 218 and not justified as voter-approved tax); *Howard Jarvis Taxpayers Ass'n v City of Salinas* (2002) 98 Cal.App.4th 1351, (property-tax-roll fee based on amount of impervious coverage on each parcel in the city to fund storm water programs was subject to Proposition 218); *Howard Jarvis Taxpayers Ass'n v City of Roseville* (2002) 97 Cal.Appr.4th 637 (in-lieu franchise fee imposed on city-operated utilities for the benefit of general fund violated Proposition 218).

[9] In *Apartment Ass'n of Los Angeles County, Inc. v City of Los Angeles* (2001) 24 Cal.4th 830, the court found a fee on residential landlords to fund Housing Code enforcement not to be property-related because it was imposed on the voluntary act of engaging in the residential rental market and not on property ownership alone. In *Richmond v Shasta Community Servs. Dist.* (2004) 32 Cal.4th 409, the court found that a water connection fee charged to new development was not a "property-related fee" subject to Proposition 218 because it was triggered by voluntary decisions to develop property. Dicta in that case suggested that ordinary water and sewer service charges do constitute property-related fees. *Id.* at 426.

[10] In determining what types of fees are subject to Proposition 218, the Supreme Court has relied heavily on the statements of the Legislative Analyst in the ballot pamphlet for the election at which Article XIIID was adopted. In the ballot pamphlet, the Legislative Analyst stated that fees for water, sewer, and refuse collection service probably meet the measure's definition of property-related fee.

"A fee for ongoing water service[11] through an existing connection is imposed 'as an incident of property ownership' because it requires nothing other than normal ownership and use of property. *Richmond, supra.* Charges for ongoing water service via an existing connection, as distinguished from connection and other charges triggered by voluntary development and other decisions of property owners are property-related fees under *Bighorn, supra.*

Next, in *Pajaro Valley Water Mgmt. Agency v Amrhein* (2007) 150 Cal.App.4th 1364, the court held a groundwater extraction charge used for programs to replenish the groundwater basin to be a property-related fee subject to Proposition 218, at least in part because such a charge for water delivered to rural households for domestic use was not meaningfully different, in the court's view, than metered fees to urban domestic water users.[12]

Substantive Restrictions on Property-Related Fees and Charges

Relationship to Cost of Water Service

Article XIIID, §6(b) provides a property-related fee[13] may not be "extended, imposed or increased by any agency unless it meets all of the following requirements":

- Revenue derived from the fee or charge must not exceed the funds required to provide the property-related service.
- Revenue from the fee or charge must not be used for any purpose other than that for which the fee or charge was imposed.
- The amount of the fee or charge imposed on any parcel or person as an incident of property ownership must not exceed the proportional cost of the service attributable to the parcel.
- The fee or charge may not be imposed for service unless the service is actually used by or immediately available to the owner of the property in question. Fees or

[11] But a fee for making a new connection to the system is not imposed 'as an incident of property ownership' because it results from the 'owner's voluntary decision to apply for the connection." *Richmond, supra.*

[12] In *Pajaro Valley Water Management Agency v. Amrhein* (2007) 150 Cal.App.4th 1364, *rev. St'd* the Pajaro Valley Water Management Agency (PVWMA) argued its fee to fund a program of environmental regulation was similarly a regulatory fee, and therefore not subject to Proposition 218. PVWMA regulates groundwater use in and around Watsonville. Over-pumping of the groundwater basin was allowing salt water from the Pacific Ocean to invade PVWMA groundwater supplies, causing environmental damage to the area. PVWMA imposed a groundwater extraction charge to fund pipelines and water purchases to increase groundwater, the purchase of other supplies to eliminate the over-drafting of the basin, and efforts to address salt water intrusion. The Court concluded the PVWMA fee was a property-related fee, more like a fee for water delivery and use than a fee to fund a regulatory program required by overdraft of the groundwater basin. The Court noted the fee might have not been property-related and exempt from Proposition 218 if it had a clearer regulatory purpose.

[13] Proposition 218 does not "[a]ffect existing laws relating to the imposition of fees or charges as a condition of property development." Cal.Const., art XIIID, §1(b). Because this exception refers to "existing laws" and not to "existing fees," it seems clear that development fees imposed subsequent to the 1996 adoption of Proposition 218 are nonetheless exempt from its provisions provided that the statutory or charter authority for those fees predated Proposition 218. Although the lower court in *Richmond v Shasta Community Servs. Dist.* (2004) 32 Cal.4th 409, had decided on this ground, the California Supreme Court did not, so no appellate authority is available on the scope of the term "development fees." In the absence of a definition of this term in Proposition 218's text, the general legal definition is likely to control. See, *e.g.,* Govt C §66000 (Fee Mitigation Act) (Govt C §66000-66008) or Stats 1987, ch 927).

charges based on potential or future use of a service are not permitted. Stand-by charges must be classified as assessments and must not be imposed without compliance with the proportionality requirements and property-owner mailed ballot protest proceedings for assessments.

- No fee or charge may be imposed for general governmental service, such as police, fire, ambulance, or libraries where the service is available to the public in substantially the same manner as to property owners.

A fee may not exceed the estimated reasonable cost to provide the service or act for which the fee is charged. If the fee exceeds those costs, it may be considered a special tax. (Art. XIIIC, §1(e); *City of Dublin v County of Alameda* (1993) 14 Cal.App.4th 264, 281; *Carlsbad Mun. Water Dist. v QLC Corp.* (1992) 2 Cal.App.4th 479, 485; Govt. Code §50076.) Items incorporated into the cost of service include costs and expenses to operate the water utility, expenses to operate, maintain, repair and replace infrastructure, the price of purchased water, costs for regulatory compliance, water treatment, outside services, material, energy, fixed expenses, capital improvements through debt, and to build up cash reserves to fund repair and replacement in future years to maintain reliable service. (See, e.g. City of Glendale Prop 218 Notice.) Fees, charges, and rates still must be reasonable, fair, and equitable in nature and proportionately representative of the costs incurred by the agency. (*Associated Homebuilders of the Greater East Bay, v City of Livermore* (1961) 56 Cal.2d 847; *United Bus. Comm'n v. City of San Diego* (1979) 91 Cal.App.3d 156, 165.) These fees must also comply with Proposition 26. (Art. XIIIC, §1(e)).

In determining the cost of or the funds required to provide the service, Proposition 218 does not define or identify the types of costs or expenses that may be included in the fee. California courts, however, have found that such costs typically include the expense of direct regulation as well as all incidental expenses, including administrative, inspection, maintenance and enforcement costs. *United Business Commission v. City of San Diego* (1979) 91 Cal.App.3d 156, 166. In fixing a fee, it is proper and reasonable to take into account not only the direct costs, but also incidental and indirect consequences that may be likely to subject the public to cost, such as the cost of complying with Proposition 218. (*Id.* at 165, quoting *County of Plumas v. Wheeler* (1906) 149 Cal. 758.)

Further, courts have long recognized that pricing a commodity such as water has an important correlation to management of water resources and that management activities are a legitimate component of the cost to provide water delivery services (*Brydon v. East Bay Municipal Util. Dist.* (1994) 24 Cal.App.4th 178, 202 - 204; *Carlton Santee Corp. v. Padre Dam Muni. Water Dist.* (1981) 120 Cal.App.3d 14, 26 – 28.) This management component does not exempt user fees from the scope of Article XIIID, as ruled by the Supreme Court in *Bighorn, supra*, but does justify compliance with Article XIIID, §6, particularly in light of Constitutional and statutory mandates to conserve water. (Art. X, §2; e.g. Water Code §375.) Preservation of scarce resources such as water has also been recognized as a legitimate cost of service that may be included as a factor in determining and apportioning fees. *Brydon, supra*; *Carlton Santee, supra.*

Proposition 218 fees may not fund general governmental services such as police, fire, ambulance

or library services, which are available to the public at large in substantially the same manner as they are to property owners.

The record supporting the adoption of the fee must estimate the costs of the activity and the basis for determining the manner in which the costs are apportioned, so that charges allocated to a payor bear a fair or reasonable relationship to the payor's burdens or benefits from the regulatory activity. (*San Diego Gas & Electric Co. v. San Diego County Air Pollution Control District* (1988) 203 Cal.App.3d 1132, 1146, cited in *Collier v. City and County of San Francisco* (2007) 151 Cal.App.4th 1326.) Little guidance, however, is available as to the meaning of the term "proportional cost" in Article XIIID, §6(b)(3), although *Silicon Valley Taxpayers' Ass'n, Inc. v Santa Clara County Open Space Auth.* (2008) 44 Cal.4th 431 discusses the proportionality requirement of Art XIIID, §4(a) for assessments. One court interpreted the requirement of Article XIIID, §6(b)(4) to require a service be "immediately available" to a property owner. A fee for that service was proper and did not need to be approved as an assessment if the means to initiate service was entirely in the property owner's control—in that case, the property owner needed only to pay a delinquent bill to have the provider unlock his meter. (*Paland v. Brooktrails Township Community Servs. Dist.* (2009) 179 Cal.App.4th 1358.)

Pass Through of Wholesale Water Charges and Adjustments for Inflation
In 2008, the Legislature, in response to the California Supreme 'Court's decision in *Bighorn, supra*, adopted AB 3030 (codified at Govt. Code §53756), which authorizes an agency such as MPWMD to adopt a schedule of fees or charges authorizing automatic adjustments that pass through increases in wholesale charges for water or adjustments for inflation, if specified requirements are met, including the adoption of a schedule of fees or charges for a period not to exceed five years.

General Fund Transfers
Calculations supporting transfers to the general fund from a utility fund subject to Proposition 218 (such as water fees) must demonstrate the fees or charges do not exceed the reasonable costs of providing that service, and describe the extent of any benefit the utility enterprise receives from general fund operations or assets. (Govt. Code §50076; See *Howard Jarvis Taxpayers Ass'n v City of Roseville* (2002) 97 Cal.App.4th 637.) Revenues derived from the fee may not be used for any purpose other than that for which the fee was imposed. A transfer into an agency's general fund may nonetheless be justified as repayment of a loan by the general fund, or as reimbursement to the general fund of the cost of services provided to the utility.

Proposition 218 Notice and Protest Requirements

Public entities must comply with Proposition '218's notice and majority protest requirements for charges related to water service as "property-related fees". *Bighorn, supra.*

Notice Requirements
MPWMD must take the following steps to impose a property-related fee or charge:

- It must identify parcels on which a fee or charge is proposed for imposition. (Art. XIIID, §6(a)(1).)

- The amount of the fee or charge proposed for each parcel must be calculated by MPWMD in light of cost-justification requirements of Article XIIID, §6(b). (Art. XIIID, §6(a)(1).)
- MPWMD must provide written notice by mail of the proposed fee or charge to the record owner of each identified parcel on which the fee or charge is proposed for imposition. (Art. XIIID, §6(a)(1). Govt. C §§53750(i)-(j), 53755(a).)

Pursuant to Article XIIID, §6(a)(1), the notice to record owners of property must contain (Cal.Const., art XIIID, The amount of the proposed fee or charge;

- The basis on which the proposed fee or charge was calculated;
- The reason for the fee or charge; and
- The date, time, and location of a public hearing on the proposed fee or charge.

Hearing Requirements

The District must conduct the public hearing on the proposed fee or charge at least 45 days after mailing the notice described above. The hearing must be conducted in accord with Article XIIID, §6(a)(2)):

- At the public hearing, the agency must consider all written protests against the fee or charge; and
- If a written protest against a proposed fee or charge is presented by a majority of owners of the identified parcels, the agency may not impose the fee or charge.

A written protest requires a majority of all affected property owners to protest the fee under the traditional "silence equals consent rule." (Art. XIIID, §6(a)(2).) Only one protest per parcel may be counted in determining whether a majority protest exists. (Govt. C §53755(b).)

Procedures for counting protests are not set forth in Proposition 218 or its implementing legislation in great detail. (See Govt. C §§53755-53756.) Therefore, the District should adopt a resolution to define "rules of the road" to clarify how it shall count protests, how it will treat those cast by other than property owners listed on the assessor's roll, and whether multiple owners and tenants must divide their protests (or whether one protest counts for all tenants and owners). The resolution shall prevent or minimize peripheral procedural issues.

No Vote is Required to Set Water Service Fees

The procedural requirements of Article XIIID, to set property-related fees, in essence create a two-tiered approach. Fees for "sewer, water, and refuse collection services" are subject to the notice, hearing and majority protest procedures. Water services are not included in the voter approval requirements set by Article XIIID, section 6 (c).

Other fees for property-related services are subject to these same notice, hearing and majority protest procedures, but are also subject to the voter-approval procedure.

Burden of Proof

In any legal action protesting the validity of a fee or charge, the burden is on the agency to

demonstrate compliance with Proposition 218. (Art. XIIID, §6(b)(5)).[14]

CONCLUSION

For the reasons stated, the MPWMD is authorized to impose rates and charges for services, facilities or water it furnishes, as well for costs of activities related to the provision of water by others. Courts recognize water pricing may include management of water resources in addition to water delivery costs. Fees may reimburse all costs to provide water service, imposed either upon persons receiving water or upon the parcel on which water use occurs. The fee is not a tax or an assessment and is expressly allowed by the California Constitution as amended by Proposition 218. To create the fee, the District must conduct a public hearing on the proposed fee, after appropriate notice, and find that a majority protest was not filed by owners of identified parcels. The water fee, however, is not subject to voter approval requirements.

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[14] In the absence of another applicable statute of limitations, the provisions of C.C.P. § 338 (a) will apply to challenges to the legality of a tax. In *Howard Jarvis Taxpayers Ass. v. City of La Habra* (2001) 25 Cal.4th 809, the Court held the three-year limitations period created by statute (C.C.P. § 338) applies to declaratory relief actions seeking to invalidate a tax.