**SUPERIOR COURT OF THE STATE OF CALIFORNIA**

**COUNTY OF SAN DIEGO**

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| DANIEL PATZ and JOAN MANN CHESNER on behalf of themselves as individuals and all others similarly situated,<br><br>Plaintiffs,<br><br>vs.<br><br>CITY OF SAN DIEGO, and DOES 1 through 200, inclusive,<br><br>Defendants. | **No. 37-2015-00023413-CU-MC-CTL**<br><br>**CERTIFIED CLASS ACTION**<br><br>Phase I Trial (Liability) Trial<br><br>**STATEMENT OF DECISION OF PLAINTIFFS AND CLASS**<br><br>DEPT: C-67<br>JUDGE: Hon. Eddie C. Sturgeon<br><br>Complaint Filed: July 14, 2015<br>Writ Hearing Date: June 21, 2021 |

**Statement of Decision**

## I. Introduction and Summary of Decision

In 1996, voters passed Proposition 218, which added Article XIII D to the California Constitution, to curb state and local government authority to generate revenue through taxes and other exactions. Proposition 218 requires water districts to calculate the actual costs of providing water at various levels of usage. When customers dispute the method used to allocate such fees, Proposition 218 requires the water district to prove, by substantial evidence that withstands independent review, that it has complied with the Constitution's substantive proportionality requirement.

Here, a certified class of single-family residential customers of Defendant City of San Diego, from August 14, 2014 to the present challenge the tiered-rate method the City used in 2013 and 2015 to allocate fees for residential water—a method that remains in place today. Thus, under Proposition 218, the City must prove that its tiered rates correspond to the actual cost of providing service at a given level of usage. The Court is not permitted to defer to the City's decision-making or apply rational-basis review. The Court must instead independently examine the record and sustain the City's ratemaking only if the City proves its compliance with Proposition 218.

To resolve this dispute, the Court need not break new ground. The allocation methods at issue bear striking resemblance to those that the California Court of Appeal has already determined violate Proposition 218. The Court's independent review of the record confirms that the same constitutional flaws identified in these other cases (*Capistrano* and *Palmdale*) are present here.

*Capistrano Taxpayers Assn., Inc. v. City of San Juan Capistrano* (2015) 235 Cal.App.4th 1493 (*Capistrano*), held that water rates that do not correlate with the actual cost of providing water at those tiered levels violate Proposition 218. And *City of Palmdale v. Palmdale Water Dist.* (2011) 198 Cal.App.4th 926, 936–937 (*Palmdale*), held that water districts cannot discriminate against certain classes of customers by charging them less, and others more, when the inequality cannot be justified by the cost of providing water to those classes.

The City's pricing scheme for single family residential customers here is fundamentally flawed in these same ways. In 2013 and 2015, the City of San Diego did not correlate its tiered prices for single-family residential customers with the actual cost of providing water at those tiered levels for a given parcel. The City instead charged high-use single-family residential customers more than the actual cost of providing water at those tiered levels. The City did so without data to justify its methodology, and rather than do that work, it adopted bald assumptions about this customer class and based rates in part on irrigation customers. Even so, all other customer classes were charged a flat rate for the same water—including irrigation customers, who are charged less for the same water than single-family residences in Tiers 3 and 4. Indeed, single-family residential customers are charged far more for the same water as a laundromat or a multi-family unit next door. But nothing in the record supports charging single-family residences more

for the same water than, commercial customers, multi-family residences, or any other customer class, and the City does not show otherwise.

This methodology for ratemaking violates established precedent. And it does so in strikingly familiar ways. After all, the same consulting firm that designed the irredeemable rate structure in *Capistrano* also designed the City's rate structure here, adhering to an industry manual on national standards, rather than following California's cost-based requirements.

The City's defense of its ratemaking fails to identify evidence in the record to support the methodology adopted, much less satisfy this Court's independent review. Perhaps sensing the weakness of its position, the City claims that its ratemaking is owed deference and need only be "reasonable." To the contrary, it is settled that the City here must prove—by substantial evidence that withstands this Court's independent review—that it charged single-family residential customers the actual cost of providing water at those tiered levels for a given parcel.

The City does not meet that demanding standard for the straightforward reason that it never did the work necessary to base its pricing methodology on actual customer data. Indeed, the City's expert (the same consultant as in *Capistrano*) admits that the City never did that work because it would have cost the City more money. It's apparently far more cost-effective for the City to follow an industry manual than to obtain and use customer data. And that is what the City did here, even after *Capistrano* rejected that approach. To be sure, water districts may use the M1 manual as a resource, but mere adherence to national guidelines do not prove compliance with California's substantive proportionality requirement.

When the City adopted its methodology, one of its main justification for its ratemaking was that the pricing tiers were dictated by costs associated with different sources of water. During this lawsuit, however, the City has all but abandoned that justification. Even the City's expert concedes that the justification makes no sense and cannot support the rate structure for single-family residences. Beyond these concessions, however, there is no evidence in the record to substantiate that the City's particular tiered rates actually reflect the costs of delivery to a given parcel, including because of different sources of water.

The City's other justifications fare no better. Based on the industry manual, but not actual data, the City assumed single-family residences use more water in the morning (peak times) and that any water consumption above a certain amount was "excessive" and thus would be penalized by charging more than the actual cost of water delivery. To set the overcharge, the City looked to data associated with irrigation (outdoor) use—because, again, it never did the work to collect usage data for single-family residences. These justifications, too, are window dressing. The City concedes it does not measure how much water single-family residences customers use on peak days and during peak hours. And while the City complains that it would be costly to employ time-of-use metering, that argument misses the mark because the City separately concedes that the cost of delivering water *does not* vary based on time of use. In fact, the City's consultant has admitted that peak use demands that are placed on the system are more attributable to other customer classes—not single-family residences.

Unable to mount a plausible defense, the City resorts to overstatement, claiming that it could only ever comply with the Constitution if it were to count molecules of water. The Constitution demands no such thing. Far from requiring perfection, the Constitution demands proof that tiered prices for single-family residential customers correlate with the actual cost of providing water at those tiered levels for a given parcel. Because the City cannot make that showing, the Court finds the City's 2013 and 2015 tiered water rates were not proportional to the cost of service attributable to each customer's parcel, as required by Proposition 218.

## II. Background and Procedural History

Plaintiffs Daniel Patz and Joan Mann Chesner are residents of San Diego, California, and water customers of Defendant City of San Diego ("the City"). The City provides water and wastewater services to residential (including both single-family and multi-family units), commercial, and industrial customers.

The City serves a population of roughly 1.4 million people, according to one estimate of the 2013 US Census Bureau. The City obtains water from two primary sources: local water and purchased water supplies from the San Diego County Water Authority (CWA). (AR005008.) Single-family residential customers account for a significant portion of all water sales by the City.

The certified Class in this case is limited to single-family residential customers like Plaintiffs Patz and Chesner and does not include multi-family residential customers who live in structures such as apartment buildings or condominiums. All of the City's water customers are subject to a rate schedule that is set by the City and its hired consultants every two to five years through a rate-making process. In addition, these rates are increased annually based upon the cost increases to the City's overall budget.

The City's water rate charges consist of a service charge and separate commodity charge for each customer class. (AR003895; AR005016.) The service charge, based on the customer's meter size, is a monthly amount which does not vary with the volume of water used by a customer and which is designed to recover the City's fixed costs. (*Id.*) The commodity charge, by contrast, is an amount based on the customer's units of consumption, measured by the number of units of water consumed during the billing cycle (measured in Hundred Cubic Feet or "HCF" units). Included in the commodity charge are the costs associated with water purchases. (*Id.*) The City's commodity charges incorporate a tiered-rate structure for single-family residential customers, with the charged rate per HCF unit of water increasing as water consumption increases. (*Id.*) By contrast, *all* other classes of customers—including multi-family residential—are charged a uniform (or flat) rate for each unit of water used regardless of their level of water consumption. (*Id.*)

Plaintiffs filed a class action complaint in July 2015, alleging that the City charges them and other single-family residential customers more for water services than it costs to provide them with these services, in violation of Proposition 218. (*See* Compl., ¶¶ 23-31.) Plaintiffs sought a declaration, injunctive relief, a writ of mandate pursuant to California Code of Civil Procedure § 1085, and damages in the form of a refund for all class members of all fees or charges assessed in violation of Proposition 218. (*Id.*, ¶¶ 42-61, p. 12.)

After briefing and argument on class certification and the applicable statute of limitations, the Court certified a class defined as "All single-family residential customers of the City of San Diego who received water service after August 14, 2014." As of 2015, the City provided water to approximately 220,000 single-family residential customers (AR005015); the certified class

includes many more than this number, however, because it includes both current and former water customers who received service within the relevant class period.

Per the parties' stipulation and this Court's order dated May 5, 2021, trial of the matter was bifurcated into two phases: Phase I (Liability) and Phase II (Damages). In Phase I, the City must prove—by substantial evidence that withstands this Court's independent review—that its charges for water service between August 2014 and the present for single-family residences do not violate Article XIII D of the California Constitution. If the City fails to meet its burden of proof, then the Court will find liability and consider remedies in Phase II.

On June 21, 2021, the parties presented oral argument to this Court on the question of liability and submitted extensive pre-trial briefing which included extensive evidence regarding this question. This Statement of Decision relates to Phase I of the trial and is based upon this Court's independent review of the evidence submitted by the parties as more fully described below.

## III. Legal Standard

California voters passed Proposition 218 in 1996. Proposition 218 is one of several voter initiatives restricting the ability of state and local governments to impose taxes and fees. (*Jacks v. City of Santa Barbara* (2017) 3 Cal. 5th 248, 258-260.) This includes Proposition 13, adopted in 1978, which limited *ad valorem* property taxes and sought to prevent local governments from increasing special taxes to offset restrictions on *ad valorem* property taxes. (*Id.*; *see also* Calif. Const. art. XIII A, §§ 1, 2.) However, at that time local governments could circumvent Proposition 13's limitations through "special assessments," which courts had concluded did not qualify as "special tax" within the meaning of Proposition 13. (*See Knox v. City of Orland* (1992) 4 Cal. 4th 132, 141.) "Consequently, without voter approval, local governments were able to increase rates for services by labeling them fees, charges, or assessments rather than taxes." (*Plantier v. Ramona Municipal Water Dist.* (2019) 7 Cal. 5th 372, 381.)

To address these concerns, voters approved Proposition 218, known as the "Right to Vote on Taxes Act," which added articles XIII C and XIII D to the California Constitution. (*Jacks, supra,* 3 Cal. 5th at p. 259.) Article XIII D, in particular, "imposes certain substantive and procedural restrictions on taxes, assessments, fees, and charges 'assessed by any agency upon any parcel of

property or upon any person as an incident of property ownership." (*City of San Buenaventura v. United Water Conservation Dist.* (2017) 3 Cal. 5th 1191, 1200, *as modified on denial of reh'g* (Feb. 21, 2018) (citing Cal. Const., art. XIII D, § 3, subd. (a)).) The California Supreme Court subsequently held that water supply is a "property related service" and is therefore subject to Proposition 218. (*Bighorn-Desert View Water Agency v. Verjil* (2006) 39 Cal. 4th 205, 214; *Richmond v. Shasta Community Services Dist.* (2004) 32 Cal. 4th 409, 426.)

**A. Proposition 218 forbids the City from charging above-cost rates**

Two aspects of article XIII D are central to this dispute. First, article XIII D states that 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." (Cal. Const., art. XIII D, § 6, subd. (b)(3).) Courts have applied this substantive limitation in striking down tiered rates that seek to keep costs low for some customers by charging above-cost rates to other customers in order to encourage conservation.

For example, in *City of Palmdale v. Palmdale Water Dist.* (2011) 198 Cal.App.4th 926, 933, *as modified* (Aug. 25, 2011) ("*Palmdale*"), the Court of Appeal held that an agency had "failed to demonstrate that its water rates are proportional to the cost of providing water service to each parcel as required" under Proposition 218. The *Palmdale* Court found two faults with the agency's ratemaking. First, the agency had discriminated against a certain class of customers (irrigation-only customers) by charging them more (and charging residential and business customers less) for water. (*Id.* at p. 937.) Second, the agency had never attempted to justify the inequality "in the cost of providing water" to its various classes of customers at each tiered level. (*Id.*) As such, its pricing per tier was not based on costs of service for those tiers. (*See id.*)

Likewise, in *Capistrano*, 235 Cal.App.4th 1493, the Court of Appeal affirmed a trial court ruling that the City of San Juan Capistrano had failed to prove compliance with Proposition 218. The Court of Appeal concluded that the City "had to do more than merely balance its total costs of service with its total revenues." (*Id.* at p. 1506.) It "also had to correlate its tiered prices with the actual cost of providing water at those tiered levels." (*Id.*)

But the City of San Juan Capistrano had not done so. The city had identified four tiers of ratepayers by usage from "low" to "very excessive," and had assigned rates to each ascending tier by applying a multiplier to the rates for lower tiers. (*Id.* at pp. 1409, 1504–1505.) But the city did not try to correlate the incremental cost of providing service at the various tiers to the prices of water at those tiers, as required by Proposition 218. (*Id.* at pp. 1504–1505.) Instead, the city followed the American Water Works Association's ("AWWA's") M1 industry manual which recommended "a work-backwards-from-total-cost methodology in setting rates." (*Id.* at p. 1514.) Adherence to industry standards, however, did not establish compliance with Proposition 218: "The M-1 manual might show working backwards is reasonable, but it cannot excuse utilities from ascertaining cost of service now that the voters and the Constitution have chosen cost of service." (*Id.*)

Notably, the Courts in both *Palmdale* and *Capistrano* also rejected arguments that article X, Section 2 of the California Constitution, which addresses the reasonable and beneficial use of water, excuses government agencies from the substantive requirements of Proposition 218. *Palmdale* concluded: "California Constitution, article X, section 2 is not at odds with article XIII D so long as, for example, conservation is attained in a manner that 'shall not exceed the proportional cost of the service attributable to the parcel.' (Art. XIII D, § 6, subd. (b)(3).)" (*Palmdale*, 198 Cal.App.4th at pp. 936–937.) The *Capistrano* Court agreed: "nothing in article X, section 2, requires water rates to exceed the true cost of supplying that water, and in fact pricing water at its true cost is compatible with the article's theme of conservation with a view toward reasonable and beneficial use." (*Capistrano*, 235 Cal.App.4th at p. 1510.)

**B. Proposition 218 places the burden on the City to prove, with substantial evidence and upon independent review, that its rates are compliant**

The second aspect of article XIII D central to this dispute is article XIII D's placement of the burden of proof on agencies in defending actions brought under the section: "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. XIIID § 6(b). The Supreme Court has held that the traditional, deferential standards usually applicable in challenges to governmental action do *not*

apply in Proposition 218 cases. (*Silicon Valley Taxpayers' Assn., Inc. v. Santa Clara County Open Space Authority* (2008) 44 Cal.4th 431, 448.) According to *Silicon Valley*, it is not enough that a water district have substantial evidence to support its action. That substantial evidence must itself be able to withstand *independent review* by a trial court and on appeal. (*See id.* at pp. 441, 448–449 (explaining why substantial evidence to support the agency action standard was too deferential in light of Proposition's 218 liberal construction in favor of taxpayers).)[1] Accordingly, in Proposition 218 challenges, a court does not owe deference to governmental decision-making, and courts do not apply rational-basis review. (*Capistrano*, 235 Cal.App.4th at p. 1512.)

As *Silicon Valley* explains, courts have applied these strict standards for judicial review of rate setting because:

> Proposition 218 specifically states that "[t]he provisions of this act shall be *liberally construed to effectuate its purposes of limiting local government revenue and enhancing taxpayer consent.*" (Ballot Pamp., [Gen. Elec. (Nov. 5, 1996) ] text of Prop. 218, § 5, p. 109; *see* Historical Notes, [2A West's Ann. Const. (2008 supp.) foll. *Cal. Const., art. XIII C.*], at p. 85.) Also, . . . the ballot materials explained to the voters that Proposition 218 was designed to 'constrain local governments' ability to impose assessments; place extensive requirements on local governments charging assessments; shift the burden of demonstrating assessments' legality to local government; *make it easier for taxpayers to win lawsuits; and limit the methods by which local governments exact revenue from taxpayers without their consent.*

(*Silicon Valley,* 44 Cal.4th at p. 448) (emphases added.)

Throughout briefing and at trial, the City argued that its burden of proof is minimal, and the standard of review is reasonableness. It is the City's position that it is not required to prove that its rates reflect the actual cost of delivering water to a parcel, including at a particular tiered level of usage. Indeed, in its briefing and at oral argument, the City conceded that it cannot make this showing. (*See* City of San Diego's Opposition Trial Brief ("City Opp.") at 24, 38.; Reporter's Transcript of Trial, June 21, 2021, 44:14 – 22 ("[T]echnology to collect time of use data and use it for billing purposes is still in development . . . . In 2011, when the court said that tiered rates are

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[1] (*See also Capistrano,* 235 Cal.App.4th at 1507 ("[I]t is not enough that the agency have substantial evidence to support its action. That substantial evidence must itself be able to withstand independent review.").)

allowed in *Palmdale*, collecting time of use data for water billing purposes was not technically possible. In fact, this technology didn't exist for billing purposes in 2015 when the City completed its advanced metering pilot project"); *id.* at 47:16 – 28 (The Court: "Can I assume that the City of San Diego in 2015 and 2018 did not have the capacity to determine what each parcel of the single family residence had for their water consumption at peak hours?" Ms. Wharton: "Correct.").)

The City's argument that its burden of proof is minimal—and that this Court's review is limited to rational-basis review—is incorrect. The California Court of Appeal, in a published decision, recently affirmed a trial court's decision finding a water district violated Proposition 218. In so doing, the Court of Appeal rejected the same argument San Diego makes here about deference and rational-basis review:

> [Proposition 218] litigation differs in two crucial respects from typical mandamus proceedings challenging an agency's action. First, article XIII D places the burden of proving compliance with the article on the agency, rather than on the person challenging the agency's action, as in a typical mandamus proceeding. (Art. XIII D, § 6, subd. (b)(5).) Second, unlike in a typical mandamus proceeding -- in which the trial court applies a deferential standard of review to the agency's action -- the trial court exercises its independent judgment in determining whether a fee increase is consistent with article XIII D. (*Silicon Valley Taxpayers' Assn., Inc. v. Santa Clara County Open Space Authority* (2008) 44 Cal.4th 431, 437.)

(*KCSFV I, LLC v. Florin County Water District* (Cal. Ct. App., May 28, 2021, No. C088824) 2021 WL 2176803, at *2 (addressing challenge to rate increase).)

None of the cases cited by the City—including *Griffith v. Pajaro Valley Water Management Agency* (2013) 220 Cal.App.4th 586 (*Griffith II*)—suggest that this Court can ignore binding precedent such as the California Supreme Court's decision in *Silicon Valley*. The court in *Capistrano* itself distinguished *Griffith II*, explaining that "[w]hen read in context, *Griffith [II]* does not excuse water agencies from ascertaining the true costs of supplying water to various tiers of usage." (*Capistrano*, 235 Cal.App.4th at 1514.) And the court in *KCSFV I, LLC* concluded that *Moore v. City of Lemon Grove* (2015) 237 Cal.App.4th 363 (also cited by the City) did not water down a district's burden of proving proportionality. (*See KCSFV I, LLC*, 2021 WL 2176803, at *6 (water district's reliance on *Moore* is "misplaced").) The same is true of *Morgan v. Imperial*

*Irrigation Dist.* (2014) 223 Cal.App.4th 892, which addressed whether certain underlying data was reliable.

Ultimately, a water district "must generally provide evidence identifying the data used [and] analyzing the cost of service." (*KCSFV I, LLC*, 2021 WL 2176803, at *6 (finding that none of the information introduced at trial "was provided or made available to the district's customers").)

For these reasons, the Court rejects San Diego's arguments about its burden of proof.

## IV. Findings of Fact and Law

As described more fully below, upon independent review of the record and without deference to the agency, the Court holds that the City of San Diego has failed to demonstrate by substantial evidence that its 2013 and 2015 ratemakings, and the rates they imposed for single-family residential customers during the Class Period, are proportional to the cost of service attributable to each customer's parcel, as required by Proposition 218.

### A. The City of San Diego's 2013 and 2015 ratemakings both violate Proposition 218

#### 1. The City's 2013 Ratemaking

As part of the 2013 ratemaking process, San Diego hired rate consultants Black & Veatch Corporation, led by Black & Veatch consultant Ann Bui, Managing Director of the Water Advisory and Planning Business within the Management Consulting Division, to review and update its water rate methodology and set rates to go into effect in January 2014. At the time of the 2013 rate study, San Diego's rates, last updated in 2006, "differentiate[d]" between single-family residential customers, who were subject to a three-tier inclining-block rate structure, and all other customer classes, who were charged a flat rate for water regardless of usage. (AR000616; AR000639.) The City's 2006 rate consultant explained that the purpose of the tiered-rate structure for the single-family residential customer class was not to recoup the variable cost of different levels of water use, but to "encourage conservation." (AR000661-62.) To achieve this purpose, the consultant used a method described in the AWWA's M1 Manual, a national industry publication, as "base-extra capacity" to allocate a disproportionate amount of the City's capital costs to higher volume users. (*Id.*) The consultant termed the resulting rates a "conservation rate

structure," and instructed "the City [to] retain its existing tiered rate structure to encourage conservation" in the single-family residential class. (AR000662.)

For the 2013 ratemaking, San Diego did not ask Black & Veatch to examine its ongoing use of a tiered-rate structure for single-family residential customers. Instead, as the City's Expert (also Ann Bui) testified in this case, the City told Black & Veatch to "maintain the structures that were in existence, which had a tiered rate already," for single-family residential customers, and that the City "did not want to change from that." (Deposition of Ann Bui, April 5, 2021, ("Bui Depo."), 52:14 – 53:03.)

In accordance with the City's instruction, Black & Veatch's 2013 rate study provided for a tiered-rate structure for single-family residential customers and flat rates for all other customer classes. (AR003918-21.) Black & Veatch even recommended adding a new low-cost tier—set at 0 to 4 HCF of water use, and which would become the new Tier 1. The purpose of this new tier, Black & Veatch explained, was to provide an "incentive for those who conserve" and to "recognize water efficiency within this customer class. (AR003919-20.) Ms. Bui confirmed at her deposition that the Tier 1 breakpoint was set in part "to recognize water conservation" in a drought year. (Bui Depo., 79:02 – 06.)

Black & Veatch justified the low cost of Tier 1 by saying that "the units of water included in Tier 1 are priced at the lowest rate because it represents the City's least expensive source of water – local supply." (AR003920.) Yet to arrive at the breakpoint for Tier 1, Black & Veatch did not look to the City's average local water use or any incrementally higher cost of providing water at various levels of use. Rather, Black & Veatch set the Tier 1 breakpoint based on the assumptions about what the water would be used for, referencing "AWWA household usage survey data," to estimate "typical indoor residential water consumption" for a house of two persons. (AR003919.) At her deposition, Ms. Bui confirmed that this data was not a specific to San Diego's single-family residential customers. (Bui Depo., 38:14 – 39:02; 53:01 – 05; 108:01 – 25.)

Black & Veatch then set the remaining tier breakpoints in a similar fashion: first adding an allocation for (assumed) outdoor water use to reach the "typical single-family customer water consumption," of about 12 HCF (the breakpoint between Tiers 2 and 3), and then an additional

"outdoor irrigation or landscape allowance" to reach 18 HCF, the breakpoint between Tiers 3 and 4. (AR003919.) Finally, Black & Veatch stated that single family residential use of water "beyond 18 HCF per month would represent high use for this class" and would be charged the highest rate—Tier 4. (*Id.*) At her deposition, Ms. Bui confirmed that Tier 4 was set at 18 HCF because that amount was "considered high"—that is, above what Black & Veatch assumed to be typical indoor use and the typical outdoor irrigation landscape allowance—and that the number of bills at that level was "very small." (Bui Depo., 193:01 – 19.)

These justifications for the tier breakpoints in the 2013 study, which were carried over to the 2015 study (AR005040-41), echo the justifications the City of San Juan Capistrano gave for its four-tiered rate structure at issue in *Capistrano*, which was also based on a rate study performed by Black & Veatch and Ms. Bui. Tier 1 in *Capistrano*, like the lowest tier in the City's 2013 and 2015 rates here, was assumed to be "indoor usage." (*Capistrano*, 235 Cal.App.4th at 1499.) In *Capistrano*, the tier breakpoint was based on usage data from the World Health Organization; for the City, it was based on usage data from AWWA. (*Id.*) Tier 2 in *Capistrano* was considered "reasonable" usage and added an "outdoor allocation," like Tiers 2 and 3 in the City's 2013 and 2015 rate studies. (*Id.*) And the higher tiers in both *Capistrano* and the City's 2013 and 2015 rate studies were set based not on the cost of delivering this water, but on what the respective agencies considered "excessive" or "high use"—18 HCF and above. (*Id.*) Notably, Black & Veatch—which performed the rate studies for both San Diego and San Juan Capistrano—makes no effort to describe how the cost of delivering the 19th and 20th HCF to customers in a given billing cycle is somehow over 200% more than the cost of delivering the first and second HCF to that same customer. The City's expert acknowledged the similarities between San Juan Capistrano's and the City's rate structures at her deposition. (*See* Bui Depo., 188 – 194.)

In response to the Class's arguments that the breakpoints between the tiers are not based on cost (and are similar to those the City's consultant recommended in *Capistrano*), the City does not point to any evidence. Rather, the City insists that it need not provide a cost-based explanation for the tier breakpoints, because that requirement is not specifically enunciated in Proposition 218 or the *Capistrano* decision. (City Opp. at 32.) The City's argument misses the point. Although

Proposition 218 and *Capistrano* may not specify that the breakpoints between tiers must be cost-based, they do explicitly require the City to correlate its rates to the proportional cost of providing service to a parcel. (*See Capistrano*,235 Cal.App.4th at 1506.) By setting the tier breakpoints the way it did, the City chose to base its rates on the assumed use of the water (*e.g.*, indoor or outdoor use), not on the cost of providing water to a parcel.

The City's argument that the tier breakpoints are irrelevant and did not affect its rates is also unsupported and unpersuasive. (*See* City Opp. at 32.) The City did not base only the tier breakpoints on its assumptions about how the water is used; it also used those assumptions to calculate the tiered rates. As the City's expert explained, the 2013 and 2015 cost-of-service studies look to the *irrigation class's* usage patterns in setting the rates for the higher tiers of the single family residence class because it assumed that such use was for landscaping. (Opening Expert Report of Ann Bui, p. 38.) The City points to no evidence in the record to support this assumption. And worse still, the City charges single family residential customers more for water above 12 HCF than it does irrigation customers. (*See* AR003921-23; AR005042.)

The single-family residential rates that Black & Veatch proposed in its 2013 rate study, which were adopted by the City, are shown on Table 24 of the 2013 rate study and took effect January 1, 2014:

| *Tier* | *Monthly Threshold (hcf)* | *Rate ($/hcf)* |
|---|---|---|
| 1 | 0 – 4 | $3.64 |
| 2 | >4 – 12 | $4.08 |
| 3 | >12 – 18 | $5.82 |
| 4 | >18 | $8.19 |

(AR003921.) Notably, the Tier 4 rate is set at precisely 2.25x the Tier 1 rate ($3.64 x 2.25 = $8.19).

**2. The City's 2015 Ratemaking**

The City again retained Black & Veatch and Ms. Bui in 2015 to update its cost-of-service study and recalibrate "the City's rates to reflect current financial and water supply/restriction

conditions." (AR005007.) The 2015 rate study closely tracks the 2013 rate study: the 2015 study recommended that the City maintain the four-tier rate structure for single family residences with the same tier breakpoints as the 2013 study, based on the same assumptions and price signals. (*Compare* AR005040-42, *with* AR003919-21.) The 2015 study also recommended that the City maintain the uniform (flat) rate structure for all other customer classes. (AR005042.)

Based on Black & Veatch's recommendations in the 2015 rate study, the City implemented the following rates, which took effect on January 1, 2016:

| ***Tier*** | ***Monthly Threshold (hcf)*** | ***Rate ($/hcf)*** |
|---|---|---|
| 1 | 0 – 4 | $4.240 |
| 2 | >4 – 12 | $4.754 |
| 3 | >12 – 18 | $6.791 |
| 4 | >18 | $9.550 |

(AR005042.) Again, the Tier 4 rate is set at almost exactly at 2.25x the Tier 1 rate ($4.24 x 2.25 = $9.54).

Both the 2013 and 2015 rate studies told ratepayers that the price differentials between the tiers were supported by (1) the relative cost of sources of water supply and (2) the increased costs of meeting demand on the peak day and at the peak hour of use, which the City said it was allocating to the customers responsible for creating that demand by using "peaking factors." (*See* AR003919-20, AR003908-09; AR005040-41, AR005027-28.)

The rate studies gave ratepayers *no* explanation for the disparate treatment of single-family residential customers—charging them tiered rates that resulted in single-family residential customers paying 225% more for water usage in Tier 4 than in Tier 1, while multi-family, irrigation, commercial, and construction customers pay approximately the Tier 2 rate for *all* usage, regardless of volume—but the City's expert attempted to justify it after the fact by pointing to single-family residential customers' relative homogeneity in size. (Rebuttal Report of Ann Bui, p. 33.)

As described below, however, the evidence in the record does not support these purported justifications, and thus the City has failed to prove that its single-family residential rates based on Black & Veatch's 2013 and 2015 rate studies satisfy Proposition 218.

**3. The City provides no evidence to support tying single-family water rates to the relative cost of the City's sources of water supply**

The first rationale the City gave ratepayers for its continued use of a tiered-rate structure for single-family residential customers, and its justification for the new low-cost Tier 1, was the relative cost of the City's sources of water supply. Both the 2013 and 2015 cost-of-service studies explain that the "pricing differentials between the tiers" for single-family residential customers are based in part on "local and non-local water supply costs" and "changing the mix of water supplies through the tiers." (AR003919-20; AR005040-41.) Specifically, the cost-of-service studies attempt to justify pricing the "units of water included in Tier 1" at the "lowest rate" by stating that it represents the City's least expensive source of water – local supply," and pricing water in Tiers 2-4 at higher rates because as "water consumption increases beyond the base tier, water supplies to meet this demand lead to greater investments by the City in alternate sources of supply, yet at much higher costs per acre foot." (AR003920; AR005041.)

Yet over the course of this litigation, the City has tried to distance itself from this purported justification. For example, the City's expert, who had been responsible for creating the 2013 and 2015 rate studies, repeated the above language nearly verbatim in her opening report. (*See* Bui Report, p. 13.) But in her rebuttal report and at her deposition, Ms. Bui abandoned this position. She conceded that the City's local water supply was not enough to cover all Tier 1 water use, and that even if it was, because the City commingles all of its water and delivers it to customers using the same infrastructure, the City cannot ensure that higher-cost "alternative sources of supply" are being delivered to customers whose use led to the City's "greater investments" in those sources of supply. (*Compare* Bui Rebuttal Report, p. 5, *with* AR003920.) Indeed, the City's expert—agreeing with Plaintiffs' expert, Dr. Rodney Smith—admitted that tying tiered pricing to the cost of source of supply "would be impossible"—especially with regard to the City's local water supply, which is unpredictable and "may provide anywhere between 0% and 15% of City's water

needs in any given year." (Bui Rebuttal Report, p. 5; *see* Opening Expert Report of Dr. Rodney Smith, p. 16.)

At her deposition, Ms. Bui again contradicted her Opening Report and the 2013 and 2015 rate studies, testifying that although her report stated "that the units of water included in Tier 1 are priced at the lowest rate because it represents the City's least expensive source of water, local supply," the City has *never* delivered local water to Tier 1 customers only. (Bui Depo., 185:15 – 21; *accord* Smith Report, p. 16 ("The premise that local surface water supplies are separately allocated to meet Tier 1 demands is at odds with the reality of how the City's water system is operated.").) Ms. Bui also testified that "all classes of customers"—not just Tier 1 customers—"partake over the course of a month in local water," and all customers—not just Tier 2 through 4 customers—use "water purchased from CWA"—the City's only other source of water. (*Id.*, 185:22 – 186:05.) And, again agreeing with Dr. Smith, she testified that all of the City's water is "commingled." (*Compare id.*, 184:21 – 186:05, *with* Smith Report, p. 16.)

Notwithstanding the City's protestations that its rates were not intended to reward low, and penalize high, water use, Ms. Bui admitted that the new Tier 1 was added in the 2013 rate study to provide more of an "incentive for those who conserve" and continued that tier in the 2015 rate study for the same reason: "because we were still in the drought." (Bui Depo, 73:18 – 74:09.)

The City, in its briefing and at trial, likewise conceded that different customers or different tiers of use are not and could not be allocated water from different sources. (City Opp. at 31.) The City also confirmed that Tier 1 is not intended to approximate the City's local water supply or the estimated volume of local water. (*Id.*)

Ultimately, despite telling ratepayers that its tiered rates are based in part on the relative cost of its sources of water supply, and that the creation of and rate for Tier 1 are justified by the low cost of local water, the City has provided no evidence to support tying rates to the relative costs of its water sources. The City was required to, but has not, "generally provide[d] evidence identifying the data used [and] analyzing the cost of service." (*KCSFV I, LLC*, 2021 WL 2176803, at *6 (finding that none of the information introduced at trial "was provided or made available to the district's customers")).

Because the City has failed to present such evidence with regard to the source-of-supply justification it gave ratepayers, the Court finds, based on its independent review of the record and without deference to the agency, that the City's rates based on Black & Veatch's 2013 and 2015 rate studies do not comply with Proposition 218.

**4. The evidence in the record does not support Black & Veatch's peaking factor analysis**

Although the Court concludes that the rates the City charged during the class period are unconstitutional on the basis of the City's failure to provide evidence of the relative cost of its sources of water supply, the Court also reviews the City's use of "peaking factors" as a justification for its rates. Upon review of the record, the Court finds that the evidence does not support the peaking analysis in Black & Veatch's 2013 and 2015 rate studies, and for that independent reason, concludes that the City's 2013 and 2015 ratemakings do not comply with Proposition 218.

After setting the tier breakpoints, as described above, Black & Veatch followed the same formula in the 2013 and 2015 rate studies (and that the City had used in 2006) to allocate the City's revenue requirements to the various tiers. But the City fails to point to evidence in the record that shows that these allocations were based upon actual calculations of *costs of service for water to be provided to a particular parcel*, as required by Proposition 218 and *Capistrano*.

Instead, the 2013 and 2015 rate studies indicate that the City relied on the AWWA M1 manual's base-extra capacity peaking factor method in an attempt to justify the City's rates. (AR003890, AR003906-09; AR005011, AR005026-29.) The City's justification for using this method is that the City incurs "greater costs" to size its water system to meet customers' demands at peak times—on the day and at the hour of highest use—"than it would if all customers always received water at a uniform rate of use," and that the customers who cause that peak demand should be made to bear the cost of sizing the system to meet it. (Bui Rebuttal Report, p. 29.) The base-extra capacity method, which provides for calculating "peaking factors" based upon "maximum day" and "maximum hour" usage—that is, the amount of water used on the day and at the hour of maximum usage for the water system—purports to "allocate these higher peak demand

costs to those customers who exhibit the greatest peaking behaviors," and are thus responsible for causing the City to incur those extra costs. (*Id.*) For example, as the City's expert explains, "[r]esidential customers typically would have high water usage in the moming due to shower and other morning chores and similarly may reflect a high usage in the evening when residents are usually back home from work/school, etc." (Bui Report, pp. 25-26.) And "Max Day extra capacity consumption. . . typically occurs on the hottest day of the year." (*Id.*, p. 26.) Peak use, therefore, depends on *when* the water is used, not on the overall volume used in a monthly or bi-monthly period, and relies on the assumption that water costs more to deliver at different times.

Tellingly, Black & Veatch has repeated this same explanation (nearly verbatim) in proposed ratemaking it has prepared for jurisdictions not subject to Proposition 218, such as Pennsylvania. (*See* Trial Transcript, 72:23 – 73:15; Plaintiff Class's Trial Presentation, pp. 60-62.)

Applying this method in the 2013 and 2015 rate studies, Black & Veatch determined the peaking factors for San Diego's single-family residential customer class, which are expressed as ratios, to be 1.5 for maximum day and 2.25 for maximum hour. (Bui Depo, 122:02 – 11.)

The problem with this theory is that the peaking factor ratios and the cost allocations are not based on actual data. In fact, as the City's expert conceded, at the time of the 2013 and 2015 rate studies, the City simply did not know when customers used water. Although the City is now beginning to implement Advanced Metering Infrastructure which would enable it to track customer use, in 2013 and 2015, the City had no usage data for the single-family residential class (or any other customer class) because the City did not perform the studies necessary to collect that information. (Bui Depo., 118:25 – 119:17.) The City's explanation for its lack of data is that it is "very expensive to do customer demand studies to determine Max Day and Max Hour Extra Capacity factors." (Bui Report, pp. 26-27.) At trial, the City's counsel similarly explained that though the City is now implementing technology to gather time-of-use data, at the time of the 2013 and 2015 ratemakings, the City did not have that data because collecting it would have required the City to perform demand studies that it deemed were too "expensive." (Trial Transcript, 44:14 – 15; 47:12 – 28; 26:7 – 11.)

But that defense is a red herring. Nothing *requires* the City to base its pricing on "peak" usage in the first place. If the City, however, decides to charge customers based on "peak" use on the supposition that it costs the City more to deliver water at certain peak times, it must still comply with the proportionality requirement of Proposition 218, and it must have evidence to support this pricing regime. Here, although the City purports that its peaking factors are based upon "maximum day" and "maximum hour" usage, the record shows that these figures are not based on actual observed data from San Diego single-family residential customers. Instead, as shown in the cost-of-service studies, and as City's expert explained in her report, Black & Veatch calculated the peaking factors using "industry guidelines" "[i]n accordance with M1 standards" and "peak factors" that it obtained from the City's 2011 "Water Facilities Master Plan" and the "City Engineering Department." (Bui Report, p. 27; AR003913; AR005034.) At her deposition, however, the City's expert explained that the "peak factors" in the City's Master Plan are simply the historical maximum day and maximum hour usage ever observed at each facility for *all* users. (Bui Depo., 106:19 – 21.) But because the Master Plan does not break down the maximum day or hour data by customer class, and since all of the City's customers use water from the same facilities, the City simply did not know whether or how much single-family residential customers contributed to those peak usage levels. (*Id.*, 118:25 – 119:17; *see id.*, 105:22-106:21 (explaining that the Master Plan tells you "what [the facility's] max hour has been since it started monitoring the system," but "[i]t can't tell you the class").) Thus, the City did not know whether the demand levels it used to set the single-family residential rates even came from single-family residential customers and not from commercial customers or any other customer class. (*Id.*, 108:10 – 22.)

Despite lacking the necessary data, in 2013 and 2015, Black & Veatch "adopted" the demand or peaking "factors of 1.5 for the max-day demand and 2.25 for the max-hour demand" that were "set forth in the City's master plan." (*Id.*, 122:02 – 11.)

Black & Veatch then used these peaking factors to allocate nearly half of peak day costs, and all peak hour costs, to customers in Tiers 3 and 4:

| Description | Percentage of Cost Recovery in | | | | |
|---|---|---|---|---|---|
| | Tier 1 | Tier 2 | Tier 3 | Tier 4 | Total |
| Base Demand Costs | 40% | 50% | 10% | 0% | 100% |
| Maximum Day Costs | 15% | 45% | 30% | 10% | 100% |
| Maximum Hour Costs | | | 30% | 70% | 100% |

(AR003920; AR005041.)

Yet again, the City's expert conceded that the City does not have data to support these allocations, because in addition to having no way of knowing the total maximum day or maximum hour use for single-family customers, the City also had no time-of-use data during the Class period. The City therefore did not know whether a particular customer was using water on a peak day or at a peak hour:

> Q. Does the data that the City has with regard to customers, single-family residential customers, does it identify the amount of water used on particular days? Is it that level of granularity?
>
> A. At the time of the studies, we did not have that level of granularity, no.
>
> Q. So in neither 2013 or 2015 were you able -- was San Diego able to know how much water a particular customer used on a particular day?
>
> A. No, because we did not have the metering capability.
>
> ...
>
> Q. -- in the 2013 and the 2015 cost-of-service study, San Diego did not have the data granularity to identify how much water a particular person used on a particular day; is that correct?
>
> A. Yes, that is correct.

(Bui Depo., 103:20 – 104:15; *see also id.*, 197:02 – 198:06.) The City's counsel at trial confirmed that the City had no time-of-use data during the class period. (Trial Transcript, 47:12 – 28.)

Instead, the City's sole justification for charging Tier 3 and 4 users much higher rates appears to be an assumption that those users are "more likely" to be using water at peak times than

average and below average users, because they use a higher total volume of water in given billing cycle. According to the City:

> It is a reasonable assumption that proportionally higher rates of consumption have correspondingly higher contribution to peak demand and, therefore, peak demand costs. Customers with usage at Tier 3 and Tier 4 are far more likely to be consuming more water at peak times than average and below average users.

(City Opp. at 35.)

In addition to not being supported by evidence, this assumption—which meant that in 2013, customers paid 60% more for water in Tier 3 than in Tier 1, and paid 125% more for water in Tier 4 than Tier 1, (AR003921)—is also at odds with basic economic principles and the reality of how the City's water system operates. As shown in the table above, in the 2013 and 2015 rate studies, Black & Veatch allocated a disproportionate amount of the City's revenue requirements to Tier 3 and Tier 4 customers. One of Black & Veatch's explanations for this is that Tier 3 and Tier 4 customers are using water during times of peak day and peak hour use, thus requiring the system to be sized larger to accommodate higher volumes of water. (AR003920; AR005041.)

At her deposition, however, the City's expert conceded that Tier 1 and Tier 2 customers *also* use water during peak day and peak hour times, thus contributing to the need for the maximum system capacity. (Bui Depo., 199:18 – 200:01.) So do the City's other classes of customers—irrigation, construction, and multi-family residential—whom the City does *not* charge tiered rates. (*Id.*, 168:18 – 19; 170:16 – 25.) In fact, Ms. Bui conceded that customer classes other than single family residential customers contribute *more* to the need for maximum system capacity than do single-family residential customers. (*Id.*, 142:06-17.)

As such, the peaking factors do not reflect the actual cost of service to a given parcel given that *all* single-family residences users used water at peak times. Further, the other customer classes (multi-family residential, commercial, and irrigation) *also* used water on peak days and peak hours, yet they were charged the same rate for their water use no matter the extent of their monthly consumption. (*See id.*, 168:18 – 19; 170:16 – 25.) More still, the premise that Tier 3 and Tier 4 use is primarily or solely responsible for peak day and peak hour use is at odds with the reality of shared resources and with how the City's water system itself operates. The City has

simply failed to produce evidence indicating that single-family residential users in Tier 3 and 4 were any more responsible for peak use than any other single-family residential user—or that they were any more responsible than customers in any other customer class.

In conclusion, the City has not met its burden of proving by substantial evidence that peaking factors provide a connection between its rates and the proportional cost of delivering water to class members' parcels. The record provides no evidence that it actually costs more to deliver water at peak times, which the City candidly admits. But even if it did, the City does not know how much more it costs, or which customers are responsible for causing the system to peak, and thus which customers purportedly caused the City to expend costs to size the system to meet peak demand.

Because the City of San Diego does not point to any "evidence identifying the data used [or] analyzing the cost of service," and the City has no data to support this justification premised on a supposition in an industry manual, the Court concludes that the City has not shown that its use of peaking factors complies with Proposition 218. (*KCSFV I, LLC,* 2021 WL 2176803, at *6.)

**B. The City discriminates against single-family residential customers, in violation of *Palmdale***

As noted above, in 2013, the City had in place a tiered-rate structure for single family residences on the basis that it "encourage[s] conservation." (AR000661.) All other customer classes were charged a flat rate. (*Id.*) At all times, the City continued using a tiered-rate structure for single-family residential customers and flat rates for all other customer classes. (AR003918-19; AR005040-42.)

This rate differential between the classes meant that the City charged single-family residential customers far more for the same water than other classes of users. For example, in 2014, a single-family residential customer would have paid $8.19 for every HCF over 18 in a billing cycle, but a dry cleaner next door would have been charged only $4.17 for the same water. (AR0003921.) And a multi-family home using the same amount of water would have been charged only $4.34 per HCF. (AR0003921.)

The Court finds that the City has not articulated an adequate cost-based justification for using a tiered-rate structure for single-family residences and a flat rate for multi-family residential, nonresidential, construction, and irrigation customers. The City exempted these other customer classes from the stratified application of the peaking factors that it applied to single-family residential customers—despite the fact that according to the evidence provided by the City, these customer classes all used water on peak days and at peak hours. (*See* Bui Depo., 168:18 – 19; 170:16 – 25.)

The City argues that it is under no obligation to justify its use of flat rates for other customer classes. This argument misses the point. The point is that every justification that the City gives for charging single-family residential customers tiered rates applies with equal force to other customer classes.

For example, the City's expert attempts to justify the disparate treatment of single-family residential customers by pointing to the difference in size between customers in other classes:

> Customers other than SFR vary considerably in size which makes it impracticable and *inequitable* to use a fixed increasing-block rate structure for these customer classes. If such a multi-block rate structure is used, small customers (corner store, 10-unit apartment complex, 1 acre irrigated lot) would likely remain in the bottom block paying at the lowers rate, while large customers that use water because they are larger (Walmart, 200-unit apartment complex, an irrigated golf course) would pay for most of their water at the higher rates. *This would be inequitable because the larger sized customers would always pay rates in the highest tiers even when they use water efficiently for their size.* Therefore, tiered rates are not used for non-SFR customer classes.

(Bui Report, pp. 33, 34) (emphases added.) The logic employed by the City's expert in this passage should apply equally to single-family residential customers. Single-family residential customers using more than 12 HCF of water per month because they have large homes and large families are charged for water services at Tier 3 or 4 rates—even if "they use water efficiently for their size." (*See id.*) The City therefore cannot justify the pricing difference charged single-family residential customers versus other customer classes based on their relatively homogenous size.

The City also cannot justify the pricing difference by usage patterns, because as the City's expert testified, *single*-family residential and *multi*-family residential customers exhibit the same

usage patterns: "shower in the morning, go to work, come back, use the dishwasher." (Bui Depo., 109:18 – 110:06; *id.*, 110:20 – 111:03.) And "on the. . . maximum day of use, the various customer classes are contributing to that maximum use of water. . . . And the same thing with the maximum hour use," so the pricing difference cannot be explained by time of use. (*Id.*, 112:11 – 19.) Yet all other customer classes are charged a flat rate.

Notably, the pricing difference also cannot be explained by peaking factors. As the City's expert confirmed, multi-family residential customers exhibit the same peaking factors as single-family residential customers, (*id.*, 137:15 – 23), and the construction and irrigation classes exhibit *much higher* peaking factors than the single-family residential customer class, (*id.*, 138:23 – 139:13). All other customer classes also have a greater percentage of their use attributable to max day than the single-family residential class, and other than commercial, all other classes also have a larger percentage of their volume of use attributable to max hour. (*Id.*, 141:23 – 142:17; *see also* Bui Report, p. 28.) Nonetheless, *only* single-family homes are subjected to higher tiered rates based on their alleged peak use.

The Court also considered the City's attempt to distinguish its rate system from the system challenged in *Palmdale*, 198 Cal.App.4th 926, by asserting that "there is no separate requirement in Proposition 218 or the case law requiring a cost based justification for employing different rate structures for different Customer Classes." (City Opp. at 40.) While the City asserts that "the issue in *Palmdale* is not present in this case because Petitioners do not argue that one Customer Class improperly bears a disproportionately large share of the total revenue requirement relative to another Customer Class," the City ignores a key additional holding in *Palmdale*. (*See id.* at 41.) The *Palmdale* Court found fault with the Palmdale Water District's (or "PWD's") tiered-rate system not only because one customer class bore a larger share of the total revenue requirement but also because of the way the tiers of usage in *Palmdale* were priced: irrigation customers who used a great deal of water were charged far more than large users from other customer classes. (*Palmdale*, 198 Cal.App.4th at 936 ("PWD fails to identify any support in the record for the inequality *between* tiers, depending on the category of user." (emphasis in original)).)

The *Palmdale* Court noted that the tiered-rate charges of the irrigation class were unlawful because irrigation customers were charged disproportionately high tiered rates when they reached 130% of their budgeted water allocation as compared to water users from other customer classes "who do not reach such high rates until they exceed 175% (SFR/MFR) or 190% (commercial) without any showing by PWD of a corresponding disparity in the cost of providing water to these customers at such levels." (*Id.* at 937 (emphasis added).) The *Palmdale* Court noted the unfairness of this by pointing out that, unlike the irrigation customer, a residential or commercial user could inefficiently use water "without the same proportional cost because of the significant disparity in tiered rates for water use in excess of the customer's allotted water budget." (*Id.*)

So too here. The single-family residential customers here are treated even more inequitably than the irrigation customers in *Palmdale* because here, single-family residential customers are charged disproportionately high rates per HCF ($5.82 in 2013) when they use more than 12 HCF of water—that is, more than the "typical single-family customer water consumption" (AR003919)—and $8.19 per HCF when they use more than 18 HCF, as compared to water users from all of the other customer classes who are *never* charged such high rates per HCF, no matter how much water they use (AR003921). The non-single-family residential customer classes are charged the same rate per unit of water regardless of use. (*Id.*)

Like the water district in *Palmdale*, the City imposes these disproportionate rates on single-family residential Tier 3 and Tier 4 users "without any showing . . . of a corresponding disparity in the cost of providing to these customers at such levels." (*Palmdale*, 198 Cal.App.4th at 937.)

**C. *Capistrano* compels the conclusion that the City's ratemaking is unconstitutional**

The City's attempts to both distinguish *Capistrano* and argue that *Capistrano* mandates its use of peaking factors are misguided.

The City first argues that *Capistrano* is distinguishable because the water district there "did not try to calculate the incremental cost of providing water at the level of use represented by each tier" but the City here at least made an effort. (*See* City Opp. at 37-38.) Based on a review of the record, however, the Court finds little daylight between *Capistrano* and this case. In neither instance did the water district calculate the incremental cost of providing water at the level of use

represented by each tier. What is needed, and what is missing here, is "evidence identifying the data used"—and that was provided to the City's customers—and "analyzing the cost of service." (*KCSFV I, LLC*, 2021 WL 2176803, at *6.) As described above, the City has failed to do that here. If anything, the fact that the City has abandoned one of its main justifications for its pricing structure—based on sources of water—makes its failure to comply with Proposition 218 more evident than in *Capistrano*.

The City's argument that, on the other hand, *Capistrano* mandates its use of peaking factors fares no better. (City Opp. at 27-28; *id.* at 36 (citing *Capistrano*, 235 Cal.App.4th at 1503).) The portion of *Capistrano* the City cites is about the cost of developing a source of new water and whether that water would be "actually used by, or immediately available to" customers, or whether it was a "[f]ee or charge based on potential future use," which is not permitted by section (b)(4)—a different subdivision of Article XIII D, § 6, than is at issue here. (*See Capistrano*, 235 Cal.App.4th at 1501, 1503.) The court's observation that "Proposition 218 [subsection (b)(4)] protects lower-than-average users from having to pay rates that are *higher than the cost of service for them*" does not allow the City to charge higher-than-average users *more* than the actual cost of service. In fact, in the very next section of its decision addressing subsection (b)(3), which is at issue here, the *Capistrano* court held that a district could *not* overcharge higher-than-average users.

In any event, the City has not come forward with *any* evidence that there are any "lower-than-average users" here whose "levels of consumption" mean that they do not contribute to the need for the City to "upsize the system" to meet peak demand. The record and the City's own admissions show otherwise. For example, the City admits that *all* customers, regardless of their "levels of consumption," use water during peak times; thus all customers contribute to the City's need to make "capital investments" to size the system to accommodate peak demand. (*See* Bui Depo., 199:18 – 200:01.) And the City admits that all customers, including those whose total "levels of consumption" places them in Tier 1, use the more expensive water that the City purchases from CWA. (*Id.*, 185:22 – 186:05.)

The City's use of flat commodity rates for all customer classes other than single-family residential customers also undermines its argument that *Capistrano* requires it to pass on the cost to upsize facilities to customers whose marginal or incremental usage requires those facilities. For example, as described above, the City charges all commercial customers a flat rate that incorporates peaking costs regardless of their "levels of consumption"—even though a hypothetical day care center paying the commercial rate might use 1,000 times less water than a university campus paying the same rate—and thus passes on the cost of "upsizing the System to meet peak demand" to a customer whose use would certainly qualify as "below average." (*See* City Opp. at 17.) The City's arguments to the contrary are merely attorney argument; they are not based on evidence—certainly not based on any evidence given to customers when the City adopted its rates. (*KCSFV I, LLC*, 2021 WL 2176803, at *6 (disregarding post-hoc rationales of district that were not supported by evidence given to customers).)

Finally, the City's arguments ignore the fact that the Court in *Capistrano* rejected the same peaking factor analysis from Black & Veatch and consultant Ann Bui that the City relies on here. (*See* Pl. Class's Trial Presentation at 67-68.) Moreover, in both the 2013 and 2015 COSS, used a base/extra capacity method similar to the one used (and rejected by the Court) in *Capistrano* to allocate a disproportionate amount of the City's costs to higher volume users. The Court is thus not persuaded that *Capistrano* mandates the conclusion that the City's rates are constitutional.

**D. The City's failure to comply with Proposition 218 is not excusable**

Finally, the City argues that if it is held accountable then no water district will be able to comply with Proposition 218, and that Plaintiffs are asking too much by requesting that it base its rates on actual customer data. But the City's flawed ratemaking is evident—even more so given that the City made no real changes even after the Court of Appeal in *Capistrano* found that the City's same consultants had improperly relied on an industry manual rather than California requirements in proposing a rate structure.

The City suggests that Proposition 218 does not require "perfection" or "the counting of water molecules." The Court agrees. But Proposition 218 also doesn't allow the City to single out single-family residential customers for disfavor—charging them more than the actual cost of

water delivery. And though the City insists that it needs a rate structure that "serve[s] the purpose of the City," the Constitution demands a rate structure that complies with the substantive proportionality requirement of Proposition 218. (Trial Transcript, 80:19 – 21.) Here, the record shows plainly that the City charges single-family residential customers more for the same water that it delivers to all other customer classes, regardless of the time of day or the burdens their use places on the system. This practice, the Court finds, fails to show compliance with the requirements of Proposition 218.

## V. Conclusion

After careful consideration of the parties' positions, the arguments and evidence presented at the liability phase of this trial, the applicable burden of proof, binding case law, and an independent examination of the record, the Court concludes that the City of San Diego has failed to demonstrate by substantial evidence that the tiered water rates imposed by its 2013 and 2015 ratemakings are proportional to the cost of service attributable to each customer's parcel, as required by Proposition 218.

The parties are therefore ordered to prepare for the damages phase of this bifurcated trial. Within 14 days of this opinion, the parties should meet and confer and propose a trial schedule, which should include trial briefs on damages and a hearing date.

IT IS SO ORDERED.

Dated: September 13, 2021

By: Eddie C. Sturgeon
EDDIE C. STURGEON
Judge of the Superior Court