SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SAN DIEGO

MARK COZIAHR, on behalf of himself and all others similarly situated,

PLAINTIFF,

vs.

OTAY WATER DISTRICT; and DOES 1 through 200, inclusive,

DEFENDANTS.

Case No. 37-2015-00400000-CU-MC-CTL
CERTIFIED CLASS ACTION

STATEMENT OF DECISION
PHASE I

DEPT: C-67
JUDGE: Hon. Eddie C. Sturgeon

Complaint Filed: July 14, 2015
Trial Date: Dec 17, 2020

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 Otay Water District, from July 2014 to the present, challenge the method Otay used in 2013 and 2017 to allocate fees for residential water. Thus, under Proposition 218, Otay must prove by substantial evidence 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 Otay's decision-making or apply rational-basis review. The Court must independently examine the record and sustain Otay's ratemaking only if Otay proves by substantial evidence its compliance with Proposition 218.

Proposition 218 requires cost-based rates for each tier of usage. In 2013, Otay "created two different prices for essentially the same volume of water, which was deemed problematic under Proposition 218, post *Capistrano*." (AR006053) (2017 statement of Otay's consultant). Otay merely followed a ratemaking manual in setting rates based on non-cost objectives such as conservation and ability to pay. In particular, Otay followed AWWA guidelines in setting Tier 2 exactly 30% higher than Tier 1, and Tier 3 at exactly 100% more than Tier 1. Otay did not charge based on its costs of providing water at these levels. It set the breakpoints to discourage high water use, based on the assumption that more than average winter or summer use is

///

///

///

///

excessive use that should be penalized. Otay, in effect, sent a price signal to such users by charging them more for the cost of water, while charging customers in the conservation tier less.

In 2017, during the pendency of this suit, Otay changed to a uniform rate for all customer classes—except for residential customers. For residential customers, Otay eliminated the conservation tier but kept the other tiers which are not cost-based. In fact, Otay did not even change the breakpoints between tiers. Evidence in the record substantiates that Otay's ratemaking in 2017 is also based on non-cost objectives such as conservation. Indeed, when asked why Otay had switched to a uniform rate for all customer classes except for residential, Otay's consultant stated that "with residential customers, the rates should encourage efficient use . . . [and] price tiers to encourage conservation." (AR002534.) Discriminating against a certain class of customers (single-family residential customers) by charging them more for water according to tiers when commercial water is a flat rate is the precise constitutional flaw identified in *Palmdale*.

Beyond eliminating the conservation tier and keeping the same non-cost-based pricing structure for the other tiers, Otay began charging for "peak use" in 2017. Otay argues that the differences in the tiers are justified by these "peak use" charges, which Otay says reflect that water costs vary based on time of use. This explanation fails because this fee is collected as part of "fixed" costs which *do not* vary based on consumption. For example, $9 million of the total $18 million "Extra Capacity Peak-Day" costs are simply bulk Water Purchases. Because it is assessed as a fixed cost, it cannot justify differences in the tiers, which again, mirror breakpoints set in 2013 for reasons that are not cost-based.

The record also does not include any evidence that there is a difference in the cost of water used during high-use or low-use times. Also, the record does not show that Otay even has time-of-use metering, and at the trial Otay admitted that it does not collect such information, at least on a granular level. Regardless of what Otay may know about its residential customer base, the tiers

///

///

///

///

that were kept in place are not cost-based. The mere addition of fixed costs for "peak" use does nothing to bring the rates in line with Proposition 218. Substantial evidence of compliance with Proposition 218 is not found in this record.

Otay attempts to defend its rate structure through a ratemaking consultant who was not involved in the 2013 and 2017 ratemaking. This consultant (Mumm) argues that Otay's rates comply with Proposition 218 because Otay balanced its total costs of service with its total revenues. Otay asserted at trial that damages in this case would be small because Otay balances its total costs of service with its total revenues. The Court in *Capistrano* rejected this exact argument, holding that a water district "had to do more than merely balance its total costs of service with its total revenues . . . . [It] had to correlate its tiered prices with the actual cost of providing water at those tiered levels." (*Capistrano Taxpayers Assn., Inc. v. City of San Juan Capistrano* (2015) 235 Cal.App.4th 1493, 1506, *as modified* (May 19, 2015).)

Plaintiff is not arguing that tiers are per se unconstitutional. The *Capistrano* Court held that tiers that do not correspond with the actual cost of service to a given parcel violate Proposition 218, and that is the flaw with Otay's rates as well. Otay's insistence that its rates need only be reasonable is just another way of saying that rational-basis review applies when it does not.

Otay asserts that perfection is not required in its rate structure. The record shows that Otay has not calculated the actual costs of providing water at various levels of usage. The Court cannot disregard its obligation to enforce Proposition 218, particularly when Otay's failures are the same failures that *Capistrano* and *Palmdale* identified. Proposition 218 shifted the burden to water districts and demanded substantial evidence of compliance precisely to make it easier for taxpayers to win lawsuits. Otay's concern that taxpayers will be overzealous in vindicating their constitutional rights is therefore not well taken.

///

///

///

///

///

Inasmuch as Otay has suggested that it should be given a pass because *Capistrano* was issued after Otay adopted rates in 2013, that suggestion is rejected by the court in that *Capistrano* itself held a water district liable for ratemaking it had adopted in 2010. In all relevant years, Otay was required to comply with Proposition 218, which has been in effect since 1996. Its failure to do so in 2013 and again in 2017 means that the Court will proceed to the damages phase of this bifurcated trial.

II. Background and Procedural History

Plaintiff Mark Coziahr is a resident of San Diego, California, and a single-family residential customer of Defendant Otay Water District. (Second Amended Complaint (Compl.), ¶¶ 7, 10, Ex. A.) Defendant Otay Water District is a water, recycled water, and sewer service municipal district that provides water services to Plaintiff and other customers within approximately 125 square miles of southeastern San Diego County. (AR005657, AR005676.)

Otay's drinking, or potable, water rates vary among classes of service – single-family residential, multi-family residential, commercial, and irrigation. (AR006002.) All single-family customers are subject to a rate schedule that is set by Otay and its hired consultants every three to five years through a ratemaking process. (AR000015.) These rates are increased annually based upon the cost increases to the district's overall budget. (See AR000468-0469; AR004099-4103.)

Otay's water rate charges include both fixed and variable monthly charges. (AR 005953.) The fixed monthly fee is intended to cover Otay's operating and maintenance costs and increases based on the customer's water meter size. (*Id.*) Encompassed within the fixed fee are Otay's system fee as well as pass-through fees from Otay's two water suppliers: Metropolitan Water District of Southern California and San Diego County Water Authority. (*Id.*) The variable monthly rate is based on customers' water consumption. (*Id.*)

Plaintiff filed a class action complaint in July 2015, alleging that Otay charges him and other residential customers more for water services than it costs to provide them with these services, in violation of Proposition 218. (See Compl., ¶¶ 20-33.)[1] Plaintiff sought a declaration, injunctive

[1] Plaintiff's claims were originally included in the related case *Mark Coziahr et al. v. Otay Water District et al.*, No. 37-2015-00023413 (now "*Patz v. City of San Diego*"), filed on July 14, 2015.

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.*, ¶¶ 51-74, p. 14.) Otay answered the operative complaint on February 22, 2017.

After briefing and argument on class certification and the applicable stature of limitations, the Court certified a class defined as: All single-family residential customers of the Otay Water District who received water service after July 14, 2014. (Order Regarding Statute of Limitations, Sept. 9, 2019.) The settlement administrator has indicated that the certified class includes a total of 66,078 members. (Declaration of Steven M. Tindall in Support of Trial Brief and Motion to Augment Record ("Tindall Decl."), ¶ 2.)

Trial in this matter is proceeding in two phases, Phase I (Liability) and Phase II (Damages). (Order Regarding Writ and Trial Structure, Oct. 16, 2020.) On December 17, 2020, the parties presented argument on the question of liability: whether Otay can prove, by substantial evidence and upon this Court's independent review, that its charges for water service between July 2014 and the present comply with article XIII D of the California Constitution. The parties also submitted expert reports in support of their positions.

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, local governments could circumvent Proposition 13's limitations through "special assessments," which courts had concluded did not qualify as a "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

---

By Order of the Court dated January 3, 2017, Plaintiff's case was separated from the Patz action (and is deemed to have been filed on July 14, 2015 for all purposes in this action).

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.)

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).) In the time since its passage, courts have applied Proposition 218's substantive limitation to 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 court found two faults with the agency's ratemaking: it had discriminated against a certain class of customers (irrigation-only customers) by charging them more, and charging other classes of customers (residential and business customers) less for water; and it had never attempted to justify the inequality "in the cost of providing water" to its various classes of customers at each tiered level. (*Id.* at p. 937). As such,

the Court of Appeal held that the agency's pricing per tier was not based on costs of service for those tiers. (See *id.*)

Similarly, in *Capistrano Taxpayers Assn., Inc. v. City of San Juan Capistrano* (2015) 235 Cal.App.4th 1493, as *modified* (May 19, 2015), the Court of Appeal affirmed a trial court ruling that the City had failed to prove compliance with Proposition 218. The Court of Appeal in *Capistrano* concluded that the City "had to do more than merely balance its total costs of service with its total revenues." (*Id.* at p. 1506.) The district "also had to correlate its tiered prices with the actual cost of providing water at those tiered levels." (*Id.*)

The Court of Appeal held that the City 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, 1504-05.) 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 p. 1504-05.) Instead, the City followed an M-1 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.*)

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.) Accordingly, in Proposition 218 challenges, a court does not owe any deference to

governmental decision-making, and courts do not apply rational-basis review. (*Capistrano, supra,* 235 Cal.App.4th at p. 1512.)

Courts have applied these heightened 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, supra,* 44 Cal.4th at p. 448) (emphasis added).

Based on this established case law, the Court rejects any suggestion by Otay that rational-basis review applies. For example, Otay attempts to argue that its burden of proof is minimal, and the standard of review is reasonableness. According to Otay, it is not required to prove that its rates reflect the actual cost to a parcel, including at a particular tiered level of usage. In fact, Otay tells this Court that it cannot "absolutely" make that demanding showing.

Otay is wrong to suggest that its burden of proof is minimal or that this Court's review is limited to rational-basis review. As discussed, it is settled law that deferential standards usually applicable in challenges to governmental action do not apply in Article XIII D cases such as this.

Otay nevertheless attempts to sidestep this binding law, arguing, based on *California Building Industry Association v. State Water Resources Control Board* (2018) 4 Cal.5th 1032, that its rates need only be "reasonable" to survive a legal challenge under Article XIII D. (See Otay Br. at 14.) But *California Building Industry* held no such thing. To the contrary, that decision underscores that legal challenges under Article XIII D are subject to more stringent standards not applicable in types of legal challenges, such as to permitting fees.

California Building Industry concerned restrictions on the allocation of permit fees in Article XIII A, which is a separate constitutional provision not applicable here. (*Id.* at p. 1053.) Nevertheless, the plaintiff challenging permit fees in *California Building Industry* sought to rely on the heightened standard of review applied in *Capistrano*. (See *id.*)

The Supreme Court in *California Building Industry* concluded that *Capistrano*'s heightened standard of review does not apply in an Article XIII A case: "the restrictions on property-related fees in article XIII D of the state Constitution are different from those imposed on regulatory fees by article XIII A." (*California Building Industry, supra,* 4 Cal.5th at p. 1053.) Otay is thus wrong to equate the demanding burden of proof applicable in an Article XIII D case, such as in *Capistrano* and here, with the more lenient reasonableness standard applicable in an Article XIII A case. (Otay Br. at 14.)

Otay tries to evade *Capistrano*'s strict standard of review and burden of proof in another way. It argues that "[e]ncouraging prudent use of water does not violate Proposition 218" because the California Constitution "encourage[s] conservation, as required by Article X, section 2." To the contrary, the law is settled that Article X, Section 2 of the California Constitution, which addresses the reasonable and beneficial use of water, *does not* excuse the government from complying with the substantive requirements of Proposition 218.

For example, the court in *City of Palmdale v. Palmdale Water District* explained: "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).)" (*City of Palmdale v. Palmdale Water Dist.* (2011) 198 Cal.App.4th 926, 936–937, *as modified* Aug. 25, 2011.) Likewise, *Capistrano* concluded: "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, supra,* 235 Cal.App.4th at p. 1510.)

Accordingly, Otay cannot point to conservation as a justification to exceed the "true cost of supplying that water." (*Id.*) In fact, *Capistrano* itself found that water district had "effectively used revenues from the top tiers to ***subsidize*** below-cost rates for the bottom tier." (*Id.* at p. 1499.) *Capistrano* thus directly refutes Otay's arguments that subsidization for conservation's sake is permitted by the Constitution.

Lastly, Otay argues that tiered rates are constitutionally valid. (Otay Br. at 12-13.) But this begs the question whether the rates that Otay adopted in fact reflect the actual cost of service to a parcel at those tiers. Indeed, much like the water district in *Capistrano*, Otay appears to be arguing that, "even if agencies are required to calculate the actual costs of water service at various tiered levels of usage, such a calculation is necessarily . . . a legislative or quasi-legislative, discretionary matter, largely insulated from judicial review." (*Capistrano*, *supra*, 235 Cal.App.4th at p. 1505.) But the court in *Capistrano* rejected this argument. (*Id.* ("We cannot agree ....").)

Relatedly, Otay argues that "the rates cannot be set so that the rates absolutely do not exceed the cost of the service to a particular parcel." (Otay Br. at 13.) Otay, then, is all but admitting – as the water district did in *Capistrano* – that it ***cannot*** in fact prove that its rates do not "absolutely" exceed the cost of service to a parcel. (*Id.*) To the extent Otay believes that no such proof is required, it has misread the Constitution and *Capistrano*:

> If the phrase "proportional cost of the service attributable to the parcel" (italics added) is to mean anything, it has to be that article XIII D, section 6, subdivision (b)(3) assumes that there really is an ascertainable cost of the service that can be attributed to a specific—hence that little word "the"—parcel. Otherwise, the cost of service language would be meaningless. Why use the phrase "cost of the service to the parcel" if a local agency doesn't actually have to ascertain a cost of service to that particular parcel?

(235 Cal.App.4th at 1505.)

For these reasons, the Court rejects Otay's arguments that it need not prove, by substantial evidence that survives independent review, that its rates reflect the actual cost of providing water at tiered levels of use for a given parcel.

IV. Findings of Fact and Law

Upon independent review of the record and without deference to the agency, the Court holds that Otay has failed to demonstrate by substantial evidence that its 2013 and 2017 tiered water rates were proportional to the cost of service attributable to each customer's parcel, as required by Proposition 218.

A. Otay's 2013 Ratemaking violates Proposition 218.

Otay retained the engineering consultancy Atkins to review and update its water and sewer rate methodologies and rates in 2013. (AR005941 *et seq.*). Atkins completed a cost of service study in September 2013 ("2013 COSS") and wrote a report containing its recommendations. (*Id.*) Atkins stated that its rate design sought to advance multiple goals, including: "rates which are easy to understand from the customer's perspective"; "rates which are easy for the utility to administer"; "consideration of the customer's ability to pay"; "continuity, over time, of the rate making philosophy"; and "policy considerations (encouraging water conservation, economic development, etc.)." (AR005952.)

As described below, the considerations in the Atkins design, however—ability to pay, water conservation, and economic development—result in a rate-making methodology that does not comply with the California Constitution's substantive limitations on property-related fees or charges. In addition, Atkins's reliance on a national manual's recommendations is flawed because the manual does not take into account the substantive limitations imposed by the California Constitution.

At the time of the Atkins' COSS, Otay utilized a four-tiered increasing rate structure for residential users, which was put in place in 2009. The 4 tiers included a "Conservation Tier" rate applicable to the first 5 HCF[2] for single-family residential users using less than 10 HCF in a month (the average wintertime water use), as well as three block tiers above the Conservation Tier. (AR005955.) Otay's tiered block rates mean that customers are charged increasingly higher rates for each additional block of water usage. (*Id.*) The 2013 COSS continued the tiered-rate system but recommended improvements in "the tiered water rate structure, including examining the spread between tiers." (AR005945.)

In the 2013 COSS, Atkins recommended that the fixed charges change to be aligned with the national AWWA Manual's recommendation "to assure compliance with [national] industry standards which is a goal of this study." (AR005954.) The fixed charges are charged on each bill regardless of the amount of water the customer uses. Atkins stated that to achieve "conservation

[2] One hundred cubic feet (HCF), or 748 gallons of water. (AR005953.)

pricing"—that is, "providing economic incentives (a price signal) to customers to use water efficiently"—Otay should recover no more than 30% of its revenue from fixed charges. (*Id.*)

The 2013 COSS recommended that Otay maintain its four-tiered-rate structure, including the lowest-priced "Conservation Tier," which Atkins explained was intended to "provide[] economic incentives (a price signal) to customers to use water efficiently. (*Id.* at AR 005954, fn.1.) Atkins then evaluated Otay's other single-family residential variable tiers to ensure that breakpoint between the tiers were still set at the winter water use average (10 HCF) for the top of Tier 1 and the summer water use average (22 HCF) for the top of Tier 2, establishing single-family tiers as follows:

Tier	Consumption Block Start	Consumption Block End	Consumption (HCF)	Percent of Consumption
Conservation	0	[5][2]	1,060,000	14%
1	6	10	3,364,900	44%
2	11	22	2,096,500	28%
3	22+		1,082,800	14%
Total			**7,604,200**	**100%**

(Table 2-3, AR005955.)

Atkins equated the winter-water average for a single-family residence (10 HCF) to estimated *interior* water usage and made it the breakpoint for Tier 1. (*Id.*) The summer water use average for a single-family residence is 22 HCF. Atkins equated this to normal *interior plus exterior* water usage and made it the breakpoint for Tier 2. (*Id.*) Atkins stated (without identifying specific factual support) that any water usage "that is above 22 HCF monthly is considered to be excessive and for irrigation only and thus is charged at the higher Tier 3 commodity rate." (*Id.*)

Atkins noted that the "winter average water usage" equates to 14% + 44%, or 58% of the average single-family resident's use. (*Id.*) The next 28% equates to the additional usage in the summertime for "irrigations," and the remaining 14% of the average single-family resident's use "is considered excessive water use for irrigation purposes. These percentages are important

because they establish the basis for all other classes of users' tier structures." (*Id.*) Atkins provides no justification (or explanation) for why the percentage-of-use tier structures of single-family residences are the basis for all other classes of users' structures (including disparate users such as commercial, landscaping, agricultural & construction, and multi-family residential). (See AR005956.)

As with the fixed charges, Atkins made these evaluations of variable use charges with the AWWA guidelines in mind. (AR005957.) AWWA guidelines, however, are *national* guidelines—not California specific. AWWA guidelines are designed in part to promote conservation and send "price signals" to customers. This is not in line with the law in California as established in the Constitution. Atkins noted that the AWWA guidelines provide that the "consumption related cost"—that is, the variable-use charges—should be divided into "the base, maximum-day, and maximum-hour cost of service." (*Id.*) The 2013 COSS candidly acknowledges that the objective of this is to have block 1 consumption "approximate indoor usage and to charge a higher amount for outdoor usage in block 2 *to promote conservation.* Block 1 pricing is normally set just *below* the average cost of water and block 2 is set just *above* the average cost of water." (*Id.*) (emphasis added). Moreover, block 3, "which is considered to be in excess of both average interior and exterior water usage, is set at a higher price differential." (*Id.*) This is based on an assumption that "above average use of water is using a larger portion of the water system and therefore should be required to pay for the cost of maintaining this extra capacity to serve their needs. (*Id.*) All water systems must be designed for peak or excess use, not average use." (*Id.*)

In the COSS, however, Atkins makes no attempt to validate the assumption that any such "block 3" usage is using a larger portion of the water system or demonstrate that water used in block 3 is used at a "peak use" time. Atkins representative Karyn Keese informed the Board, "With regard to the allocation of costs, the District utilizes 'peaking' factors. The District uses AWWA Standards when determining peaking costs." (Tindall Decl., Ex. C, p. 000125.) Ms. Keese clarified that "peaking" "is the sizing of the District's infrastructure (water system) to handle the highest water use ('peak' use). *Residential and Multi-family use is highest in the morning and evenings* (peak in the mornings and evenings), Commercial/Government customer

water use is more steady (steady peaking), and landscape use has a high peaking factor as this class' water use is highest in the summer with little use during winter months." (*Id.* at p. 000126) (emphasis added). Ms. Keese, therefore, concedes that for residential and multi-family use, peak use depends on *when* the water is being used by the customers during the day—that is, in the mornings and evenings—not by the *overall quantity* used during the month. If, for example, a customer uses a small amount of water during the day, and only goes into the "excess" block 3 category while watering their lawn in the middle of the night, they are paying block 3 excess prices even though they are not testing the "peak use" capacity of the system.

The proposed rates were set as follows:

Consumption Blocks in Units and Usage Fee - 2014 Proposed and 2015-2018 Projected

Consumption Blocks (in Units)	Current	2014 Proposed	2015 Projected	2016 Projected	2017 Projected	2018 Projected
Conservation Tier[3]	$1.73	$1.86	$2.00	$2.15	$2.31	$2.37
6 - 10	$2.69	$2.90	$3.11	$3.35	$3.60	$3.68
11 - 22	$3.50	$3.77	$4.05	$4.35	$4.68	$4.79
23 or more	$5.39	$5.80	$6.24	$6.71	$7.21	$7.37

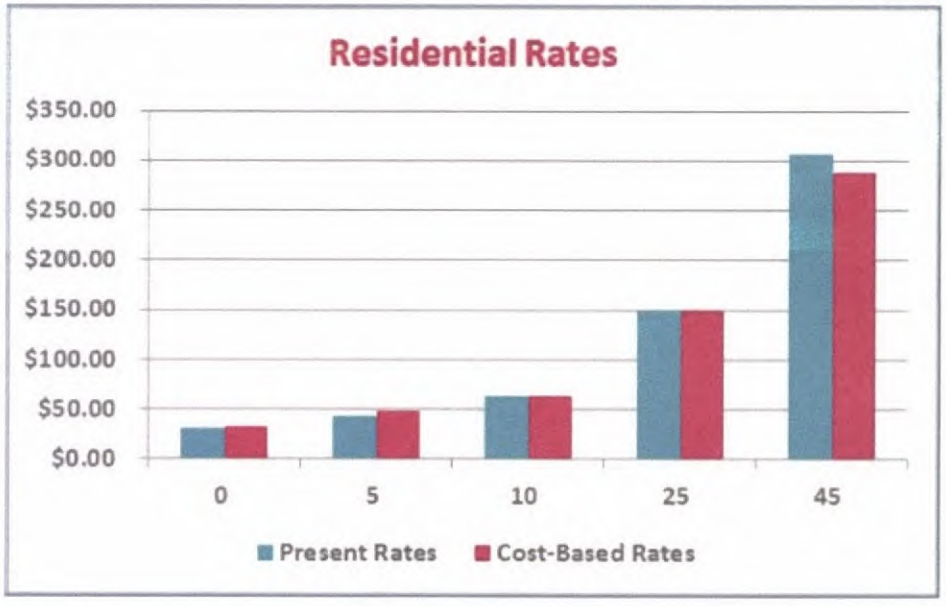
(AR000438.) These proposed rate increases were approved by the Otay Water District Board of Directors. (See AR000270 and AR000271.)

To set the pricing model, Atkins followed the AWWA in setting block 2 (that is, the 11-22 HCF block) at a level 30% higher than block 1 (the 6 -10 HCF block) "to reflect the cost incurred for increased capacity costs and supply purchases. Block 3 [the 23 or more HCF block] is then set at a price differential of 2 times the rate of block 1 because the capacity requirement is twice that of block 2 (e.g., single family block 1 breakpoint is 10 HCF and block 3 begins at 23 HCF)." (AR005957.)

[3] The COSS notes that the "Conservation Tier discount applies toward the first five units of water when overall consumption is ten units or less." (AR000438.)

Moreover, the COSS does not provide any explanation or justification for (1) why the Conservation Tier ($1.86) is 56% *less than* Block 1 ($2.90), which is already "set just below the average cost of water" (see AR005957), or (2) why Block 3 ($5.80) is *380% higher* than the "Conservation Tier" ($1.86). The COSS makes no effort to describe how the cost to deliver the 23rd and 24th HCF of water to customers in a month is somehow nearly four times as expensive as the cost to deliver the first and second HCF to that same customer.

As Otay's consultant for the 2017 COSS, HDR, later conceded, the Conservation Tier from the 2013 COSS "was intended to encourage efficient use by low use customers." (AR006040). Each pricing tier, however, "must be cost-based. Subsidized or non-cost based pricing tiers were recently found (ruled) to be illegal under Proposition 218." (*Id.*) To address *Capistrano*, Otay decided to eliminate the "[s]ubsidized or non-cost based" Conservation Tier and have the revised Tier 1 include 0 to 10 HCF. (*Id.*) In fact, Otay's consultants included a graph that compared its 2013 rates "present rates" to rates that its consultants believed would be cost based.



(AR004013.)

Otay and its consultants, therefore, ignored the key requirement of Proposition 218: setting the rates based upon the "cost of service" and making sure that they do not exceed the proportional cost of service attributable to a parcel. Instead, the rates were set to send price signals or promote conservation—which meant that customers whose water use put them in Tiers 2 and 3

in a given month were subsidizing the below-cost users in the Conservation Tier and Tier 1. (See AR005957 (objective is to set block 1 prices below the average cost of water, block 2 above the average cost, and block 3 as the "penalty block.") (see also Tindall Decl. Ex. B at p. 00615.)

Indeed, the Atkins report does not support the conclusion that customers were charged based on the actual cost of providing water at tiered levels of use for a given parcel. Instead, "[c]onservation was a central tenet of the rate structure from FY 2014 through FY 2017." (Vondle Reply Decl. ¶ 15.)[4]

> One of the tasks of the Atkins study was to, "Review current water and sewer rate structures to insure that they provide equity among customer classes while promoting water conservation and following best practices." (004085). Also, "Any water usage that is above 22 HCF monthly is considered to be excessive and for irrigation only and thus is charged at the higher Tier 3 commodity rate." (004095) This is evidence of the Otay Water District's rates promoting conservation and punishing higher-than-average use customers.

(*Id.*)

Still more, the Atkins study "has no objective evidence based on studies of the Otay Water District system that Tier 3 level costs are more than three times the Conservation Tier level costs." (Vondle Reply Decl. ¶ 24.) What accounts for this differential? Otay merely followed a rate-setting manual:

> The differential seems to be the result of following the generic guidelines from the AWWA as stated in the Atkins Study, "AWWA suggests that block 2 should be set at a level 30 percent higher than block 1 to reflect the cost incurred for increased capacity costs and supply purchases. Block 3 is then set at a price differential of 2 times the rate of block 1." (AR004097). *There is no cost analysis cited to support this arbitrary rate setting.*

(Vondle Reply Decl. ¶ 24) (emphasis added). Adherence to industry standards, however, does not establish compliance with Proposition 218. (*Capistrano*, *supra*, 235 Cal.App.4th at p. 1514 ("The M–1 manual might show working backwards is reasonable, but it cannot excuse utilities from

[4] Otay is wrong to suggest (Otay Br. at 22) that the Conservation Tier proposed by Atkins in 2013 is only apparent if one considers the rate study from 2008. The Atkins report and the HDR report both acknowledge this point. (*See* AR005953 (Atkins); AR006036 (HDR).)

ascertaining cost of service now that the voters and the Constitution have chosen cost of service.").)

Seeking to salvage Atkins, Otay has submitted a declaration and (practically verbatim) report of Jason Mumm, who was not involved in the Atkins report. Notably, Otay has not submitted a declaration from anyone who was involved in the Atkins report or the HDR report. Much of Mr. Mumm's discussion of the Atkins report improperly conflates the Atkins report (relevant to fiscal years 2014 to 2017) with the HDR report (relevant to fiscal years 2018 and onward), which proposed certain changes, it said, precisely *because* the rates proposed by Atkins were not in line with the Constitution. (See AR006036, n.8.)

Contrary to the record, Mr. Mumm contends that Atkins proposed to recover peaking costs through volumetric charges. Atkins proposed no such thing. Mr. Mumm cites nothing in the Atkins report to support his speculation, and "there is no direct connection between the peaking method described in the 2017 HDR Report and the rates developed for the FY 2014 – FY 2017 period. Otay Water District capacity costs have never been recovered in the volumetric rate." (Vondle Reply Decl. ¶ 35; see also *id.* ¶ 55 ("The Atkins Report uses the word 'peak' one time: 'All water systems must be designed for peak or excess use, not average use.' (AR004097). Atkins did not use a 'peaking factor' concept in calculating the rates.").)

Mr. Mumm does not even define "peaking factor" in his declaration, but his allusion to the recovery of peak costs for, say, electricity, is inapt for reasons that Mr. Vondle explains:

> The same peak costs for electricity use do not apply to the Otay water system. Water is purchased in bulk and stored for later use in reservoirs. *There is no difference in the cost of water used during high use or low use times. There is no higher cost source of water used in higher than average use periods.* The reservoirs are typically filled at night using low cost electricity, and then the water is released to match demand throughout the day. High water use (peak) times do not use a higher cost source of water.
>
> The costs of the larger system capacity built for use in higher use periods is recovered in the fixed charges based upon meter size. The capacity costs are not recovered in the water commodity rates, and there is no actual additional cost for water used at peak periods. The costs of the capacity are the fixed costs of reservoirs and transmission and distribution lines. In the Otay Water District, under both the Atkins study and the HDR study, these capacity costs

> are appropriately recovered from the fixed fees charged to customers based on meter size, not flow.

(Vondle Reply Decl. ¶¶ 48-49) (emphasis added).

Apart from the fact that that the record fails to establish "material differences in the water commodity cost at different times of the day," it is beyond dispute that Otay does not have time-of-use metering. Consequently, Otay "could not accurately bill the higher cost of 'peak' water (if there were any) to the customer using the water at the peak time. ... In fact, without time-of-use metering, the Otay Water District cannot objectively determine usage patterns by individual customers or classes of customers." (Vondle Reply Decl. ¶ 50.)

For these reasons, the Atkins report and the administrative record establish that Otay required above-average users to subsidize below-cost rates. Otay's and Mr. Mumm's arguments to the contrary simply misstate the record, including what Atkins proposed and Otay implemented. Consequently, the Court finds that Otay has failed to demonstrate by substantial evidence that the rates proposed by Atkins and adopted for fiscal years 2014 to 2017 were proportional to the cost of service attributable to each customer's parcel.

B. Otay's 2017 Ratemaking continues to violate Proposition 218

After the *Capistrano* decision—and indeed after this lawsuit was filed—Otay retained consultant HDR Engineering to conduct a rate study and propose new rates to take effect in January 2018. (AR002536–2538; AR005997, *et seq.*) The stated purpose of HDR's study was to evaluate Otay's existing tiered-rate system in light of changes in "the legal environment" since the 2013 COSS. (AR002536.) Specifically, HDR explained, "since the completion and adoption of the District's rates in 2013, additional court cases within California have further clarified the issue of defining a 'cost-based' rate structure which meets the legal requirements of Proposition 218." (AR002537, AR002545.) HDR cited the Court of Appeal's decision in *Capistrano* as one of those "court cases." (See AR002546.)

Otay's 2017 COSS acknowledges Proposition 218's requirements relating to the structure of rates to ensure that customers are charged only the actual cost of service—and admits outright that Otay's prior rates violated Proposition 218:

> The State of California has certain well-established legal constraints regarding utility rate making, of which the California Constitution Article XIII D, Section 6 (commonly referred to as "Proposition 218"), is at the forefront. Proposition 218 requires a water (and sewer) utility to establish *cost-based rates for the services provided.* At the time of the last comprehensive water rate study conducted for the District in 2013, the technical analysis was structured and developed to comply with the requirements of Proposition 218. However, since the completion and adoption of the District's rates in 2013, additional court cases within California have further clarified the issue of defining a "cost-based" rate structure which meets the legal requirements of Proposition 218.

(AR002537) (emphasis added). The 2017 COSS, therefore, recognized that Otay's previous rates did not meet the definition of cost-based rate structures that California court cases "clarified."

As such, HDR's 2017 cost of service study ("2017 COSS") recommended several changes to Otay's rates in an attempt to comply with Otay's new understanding of Proposition 218, as defined by those "Court cases." These changes included eliminating the conservation tier for residential single-family users (resulting in higher charges to lower water users and lower charges to high water users); modifying meter size fixed fees "from the current flat rate for all customers based on meter size to a fee based on both customer type and meter size"; and implementing a single flat rate structure for irrigation, commercial, and public customers because "the tiered rate cost differential is minimal and provides no discernable benefit." (AR002536-2539.) However, as explained by HDR's representative, the 2017 COSS recommended that Otay maintain its tiered-rate system for single-family residential members because "with residential customers, the rates should encourage efficient use. . . if the District moved to a uniform rate for residential users . . . [t]his would provide a significant benefit to the larger users and could encourage more water use." (AR002534.)

Notably, Otay changed to a uniform (or flat) rate for all customer classes—except for residential customers. In *Palmdale*, the Court of Appeal held that an agency violated Proposition 218 in part by discriminating against a certain class of customers (irrigation-only customers) by charging them more (and charging residential and business customers less) for water. (198 Cal.App.4th at p. 937.) So too here, Otay has discriminated against single-family residential customers by charging them more for water according to tiers than other classes of customers, such as commercial water customers, who are charged a flat rate. This is the same flaw identified in *Palmdale*. Otay has not provided any cogent reason for this differential treatment, and none is

apparent in the record given that the water sources and cost of delivery appear to be the same. The only explanation in the record is that Otay decided to keep non-cost-based rates for residential customers to "encourage efficient use," but to discontinue such measures for other classes. (AR002534.)

Although Otay adopted the changes recommended by the study, the 2017 rate setting failed to address the underlying defects in Otay's single-family residential rate structure, which, as HDR recognized, had been "specifically designed to encourage conservation of water." (AR006052.) Otay continued to use the remaining three tiers, attempting to justifying them after the fact by pointing to unsubstantiated "peaking factors." (AR006040-6041.) As a result, even as Otay moved to a uniform rate for most customer classes, it maintained a tiered-rate system for class members, based an unconstitutional policy of "pric[ing] tiers to encourage conservation." (AR002525, AR002534.) This methodology, and the rates it ultimately proposed, are inconsistent with the Proposition 218's requirements that rates reflect the reasonable cost of providing water.

The most notable change in the 2017 rate setting was the elimination of the conservation tier for the first 5 HCF for customers using 10 HCF a month or less. In recommending the change, the 2017 COSS explained that the conservation tier "was established by the District prior to the 2013 rate study conducted by Atkins, and was intended to encourage efficient use by low use customers. As this study will detail, each pricing tier must be cost-based. Subsidized or non-cost based pricing tiers were recently found (ruled) to be illegal under Proposition 218. To address this recent court ruling, the conservation tier was eliminated and the residential rate restructured to three tiers (0 – 10 CCF, 11 – 22 CCF and over 22 CCF)." (AR006040.)

HDR further explained:

> Th[e conservation] tier was put in place to encourage efficient use, but it also addressed affordability concerns for low-users by providing a low-cost tier. Past and more recent court decisions related to Proposition 218 have made it clear that there must be a cost-basis for the pricing of each consumption tier. At the same time, a rate cannot be subsidized to the detriment of other ratepayers. In this particular case, the cost of service did not indicate a cost-basis for the current first tier price of $2.53/CCF, but in order to maintain it, other ratepayers would need to subsidize the low-use customers, which would seem to violate the legal requirements of Proposition 218. At the same time, the customer who is eligible for the conservation tier paid $2.53/CCF for their first five (5) CCF of water. An ineligible customer would pay $3.95/CCF for their first five (5) CCF of water.

This created two different prices for essentially the same volume of water, which was deemed problematic under Proposition 218, post *Capistrano*."

(AR006053.)

As HDR explained, "rates that are strictly cost-based [ ] do[ ] not consider other non-cost based goals and objectives (conservation, economic development, ability to pay, revenue stability, etc.). (AR006017.) Therefore, HDR recommended "the elimination of 'conservation tier' pricing subsidy" by combining the prior first and second tiers (the conservation tier and Tier 1). (AR006041.) HDR recommended that Otay's remaining "residential tier sizes remain intact," (*id.*), and proposed the following rates:

Table 6
Review of the Residential Rate Design

Current Residential Rate		Proposed Residential Rate	
Monthly System Fee [1] -		**Monthly System Fee -**	
3/4"	$15.91	3/4"	$17.24
1"	22.47	1"	24.36
1-1/2"	38.88	1-1/2"	42.15
2"	58.55	2"	63.48
Plus: MWD/CWA Fee [1] -		**Plus: MWD/CWA Fee -**	
3/4"	$15.00	3/4"	$15.20
1"	27.84	1"	28.21
1-1/2"	62.96	1-1/2"	63.80
2"	107.08	2"	108.51
Plus: Usage Charges		**Plus: Usage Charges**	
1 – 5 [2]	$2.53/CCF	1 – 10	$3.03/CCF
6 – 10	$3.95/CCF	11 – 22	$5.40/CCF
11 – 22	$5.13/CCF	23 – Over	$6.97/CCF
23 – up	$7.90/CCF		

[1] – Current rate schedule has fees for 3" through 10" meters. Largest residential meter currently installed is a 2" meter.

[2] – Customers whose total consumption is 10 units or less per month shall receive a benefit of a lower rate for units 1 – 5. One unit (CCF) equals 748 gallons.

(AR002556.)

Despite HDR's recommendation, which Otay implemented, merely eliminating the Conservation Tier did not bring Otay's tiered-rate structure into compliance with Proposition 218 because HDR's 2017 cost-of-service report failed to address whether the remaining three tiers (or their breakpoints) are proper based on the cost of providing service. In fact, the HDR report provides no explanation or evidence at all to justify the remaining tiers or their breakpoints,

saying only that HDR reviewed the tiers set by Atkins, adjusted the summer and winter levels based on average usage, and otherwise left them in place. (AR006040-AR006041.)

As shown in the chart below, the effect of eliminating the conservation tier resulted in lower rates for average (indicated by the blue bar) and above-average use customers, and higher rates for below-average use customers. This shows that the conservation tier had saved low users money at the cost of average and above-average users who were required to subsidize the below-cost rates in the conservation Tier and Tier 1. In the COSS, HDR admitted that the higher-use customers had been charged more than the cost of service, and that under the new rates, they "will see a reduction in their bill, primarily as a result of the reduction of the tail block price *to a cost-based level*." (AR006010) (emphasis added).

Residential Rates - 3/4"

Consumption (CCF)	Present Rates	Cost-Based Rates	Difference $	Difference %
0	$30.91	$32.44	$1.53	4.9%
1	33.44	35.47	2.03	6.1%
2	35.97	38.50	2.53	7.0%
3	38.50	41.53	3.03	7.9%
4	41.03	44.56	3.53	8.6%
5	43.56	47.59	4.03	9.3%
6	47.51	50.62	3.11	6.5%
7	51.46	53.65	2.19	4.3%
8	55.41	56.68	1.27	2.3%
9	59.36	59.71	0.35	0.6%
10	63.31	62.74	(0.57)	-0.9%
25	148.57	148.45	(0.12)	-0.1%
45	306.57	287.85	(18.72)	-6.1%

Present Rates		*Cost-Based Rates*	
Fixed Charge	$/Acct.	Fixed Charge	$/Acct.
3/4"	$15.91	3/4"	$17.24
CWA / MWD Fees	$/Acct.	CWA / MWD Fees	$/Acct.
3/4"	$15.00	3/4"	$15.20
Consumption Charge	$/CCF	Consumption Charge	$/CCF
1 - 5*	$2.53	0 - 10	$3.03
5 - 10	3.95	10 - 22	5.40
10 - 22	5.13	22 +	6.97
22 +	7.90		

**Customers must use < 10 CCF to be eligible for tier 1 pricing*

(AR006010.)

Further describing the impact that these recommended rate changes would have on "high-use customers" charged in the 22 HCF and above "tail-block" tier, HDR explained:

> In this case, the revised cost-based rate structure has reduced the tail-block price from $7.90/CCF to $6.97/CCF. Historically, the common utility perspective with regard to the tail block was to provide a "price signal" or incentive to encourage more efficient outdoor water use. At some utilities, the tail block price was not established at a cost-based level, but rather, at some level which would gain the customer's attention and provide a price incentive to modify the customer's water consumption behavior. The recent *Capistrano* decision clearly ruled that establishing the tail block absent any cost-basis was illegal under the requirements of Proposition 218. The *Capistrano* decision did not find that tiered rates were illegal under Proposition 218, but that each pricing tier must have a cost-basis."

(AR006055.)

Although the 2017 ratemaking eliminated the admittedly below-cost conservation tier, it did not address the underlying flaws in Otay's tiered rate structure, which, as HDR recognized, had been "specifically designed to encourage conservation of water." (AR006052.) Instead, after combining the first two tiers, HDR left the remaining tiers intact and worked backwards to try to justify them using AWWA's "peaking factors" methodology. (AR006040-6041.) This methodology, and the rates it ultimately proposed, are inconsistent with the Proposition 218's requirements that rates reflect the reasonable cost of providing water.

1. HDR's peaking factor analysis is flawed.

In its pre-trial submission and at trial, Otay relied on HDR's "peaking factor" analysis to justify its use of tiered rates. HDR's peaking analysis is flawed for two main reasons and does not support Otay's tiered rates.

First, as explained above, Otay's tiers, and the rates it charges, are based on the volume of water that customers use in a given month, with each tier of water priced higher than the one before it. In order to justify the higher rates, Otay allocates certain costs, which HDR refers to as "Extra Capacity Peak Day" costs, disproportionately to the higher tiers. (*See* AR006027.) But the expenses HDR puts in the Extra Capacity Peak Day category are not disproportionately greater for larger volumes of water use. Rather, they are fixed expenses, such as water purchases and infrastructure, that cost the same for the first gallon of water delivered or the 23rd. Indeed, Otay already recovers most of these costs through other line items on customers' bills, which shows that they are fixed—not variable—costs. (*See* Vondle Reply Decl. ¶ 49.) Therefore, these expenses cannot form the basis for disproportionately higher rates for the higher tiers.

Second, even if delivering service to customers at "peak" times did cost more—which Otay has not proven—Otay does not collect time-of-use data, as it admitted at trial. Thus, Otay also does not—and cannot—charge customers more based on when they use water, because it does not have time-of-use meters.

a. The expenses HDR allocates to peaking are not variable costs.

In an attempt to justify Otay's rates, HDR's report in 2017 arbitrarily recategorizes certain of Otay's non-capacity related revenue requirements to a new "Extra Capacity Peak Day" cost category that it then allocates to the higher tiers. But the expenses HDR allocates to this category are not variable costs that increase disproportionately with higher volume use. Rather, as Vondle explains:

> They are Water Purchases, Equipment, and various Materials and Maintenance expenses. *For example, $9 million of the total $18 million "Extra Capacity Peak-Day" costs are simply bulk Water Purchases.* (AR006082.) These costs are not related to "peak" use. They vary based on the volume of water used without regard to base or peak days and are appropriately recovered in a flat rate for each unit of water used. For example, there is no difference in the cost of bulk purchased water during low use periods or high use periods. The other costs included similarly do not change because of high use or low use periods. The actual capacity costs of the larger reservoirs and pipes for peak day and potential fire flow are recovered in the fixed fee, not the variable commodity rate.

(Vondle Reply Decl. ¶ 58) (emphasis added).

Therefore, contrary to Otay's assertion that "the peaking factor was rational and the rates that resulted from it were reasonably related to the cost of providing the service," (Otay Br. at 24, citing Mumm Decl., ¶¶ 34-53), it appears that "the HDR study introduced the theoretical 'peaking' concept" for the express purpose of justifying Otay's tiered residential rates. (Vondle Reply Decl. ¶ 59). Indeed, HDR's cost-of-service report says: "In this particular study, additional cost detail was needed to justify the cost-basis for the District's tiered (increasing) block rate structures...This level of detail is required to provide the cost-basis for tiered rates and meet Proposition 218 legal requirements." (AR006029.) However, "neither HDR nor the District developed any 'additional cost detail' through objective studies of the Otay water system." (Vondle Decl., ¶ 25.) As such, HDR arbitrarily assigned "non-capacity related costs to

'Extra Capacity Peak Day' resulting in an artificial calculation of imaginary peak day costs to justify the District's tiered rates." (*Id.*)

Because Otay fails to provide any evidence that the costs that HDR's 2017 cost-of-service study associates with "peaking" actually increase based on the volume of use, the peaking analysis does not show that the rates Otay charges to users in higher tiers are justified due to the proportional cost of service of delivering water to customers in those tiers.

b. Even if peak day and peak hour water use did cost more, Otay would not know and could not charge higher rates on that basis.

According to the 2017 COSS, the theoretical costs associated with "peaking" relate to *when* customers choose to use their water, not *how much* water they use. However, as Otay admits, its "customers are charged for the volume of water they consume per month, not the time of use." (See Otay Br. at 16, quoting Pls' Opening Br. at 19.)

This system is incongruous with the basis for the peaking factor analysis. The core of Otay's justification for peaking factors is that delivering water costs more based on the *time* it is used. For example, in support of its argument that HDR's peaking factor analysis is valid, Otay explains:

- "Use is greater *during the day* than *at night*; much more in the *summer* than in the *winter*";
- "People do not use the same amount of water every *day* or every *month*";
- "Peak demand is . . . measured by peak day (a hot summer day), sometimes peak hour (a late afternoon on a hot day during a forest fire)";
- A water agency must be prepared to provide the water demanded by customers at that worst possible *moment*."

(*Id.* at 15.)

Given Otay's explanation of the peaking factor, if the costs attributed to peaking were in fact variable (which Otay has not shown), the equitable and constitutional way of allocating those costs would be based on *time of use*: water would cost more during the day than at night and more

during the summer than in the winter. But as Otay concedes, "District customers are charged for the *volume* of water they consume per month, *not the time of use*." (*Id.* at 16, emphases added.)

Otay also cites to the HDR report and the Mumm Declaration for the proposition that "Peaking factors are utilized for discerning differences in cost." (Otay Br. at 16, citing AR006017-18 & Mumm Decl., ¶¶ 33, 37.)

The HDR report's explanation for peaking is again, based on *time*:

> The major cost difference associated with serving a customer in Tier 3 versus Tier 1 is primarily driven around peak use demands. . . . For example, ***a Tier 3 customer may have high summer use*** creating large demands on the District's system. . . . By following [the] basic cost principle [that those who create the peak demand costs should pay for the peak demand costs], those customers creating the peak demands on the system ***in the summer, pay an equitable and proportional share of the cost of those facilities.***

(See AR006017-18) (emphasis added).[5]

But again, Otay does not charge customers based on time of use, it charges them based on volume. And, even if delivering water to users at peak day or peak hour times was more expensive (it is not), Otay would not know, and could not charge customers more on that basis because it does not have time-of-use metering. Because Otay lacks this information, it also cannot meet its burden of proving that the cost of delivering water at "peak day" or "peak hour" times is—even theoretically—more expensive than delivering water at any other time.

In his Reply Declaration, Vondle compares Otay's system to a true peaking system, such as an electrical utility, which uses time-of-use metering so that customers can be charged the higher costs of peak electricity use. (Vondle Decl., ¶ 47.) In such a system:

> Typically, the greater the system demand for electricity in an hour, the higher the cost. This is because of economic dispatch. The lowest cost source of power is used first and higher cost sources are added as demand increases. The actual real cost of a kilowatt hour of electricity rises as demand increases in a day because higher cost sources of power are added. There is a legitimate higher cost of "peak" use, and time-of-use meters allow the electric utilities to pass the higher costs of peak use to the actual customers using the peak cost electricity.

---

[5] The paragraphs in the Mumm Declaration Otay cites do not help either. Paragraph 33 has nothing to do with peaking and paragraph 37 cites to no evidence. (*See* Mumm Decl., ¶¶ 33 and 37.)

(*Id.*) But, as Vondle explains: "There is no difference in the cost of water used during high use or low use times. There is no higher cost source of water used in higher than average use periods." (*Id.*, ¶ 48.)

In sum, Otay's peaking factor analysis is flawed because it relies on a faulty premise that it cannot support with substantial evidence: that delivering water at "peak use" times is more expensive. Worse, Otay does not even try to calculate the cost of delivering water at different times, or charge customers more based on their time of use. Otay has therefore failed to meet its burden of proving, by substantial evidence, that its tiered-rate structure is based on the proportional cost of delivering water.

2. Mr. Mumm's "Total Cost" approach does not prove Otay's rates are constitutional.

Finally, Otay claims that its expert Jason Mumm can independently verify the constitutionality of Otay's rates from 2013 to 2018 by looking at the average price per unit. Mr. Mumm's analysis—which was not used by either Atkins or HDR to calculate rates during the class period—does not support Otay's rates for several reasons.

First, Mr. Mumm's approach is contrary to *Capistrano*, which held that a water district "had to do more than merely balance its total costs of service with its total revenues . . . . [It] had to correlate its tiered prices with the actual cost of providing water at those tiered levels." (235 Cal. App. 4th at p. 1506.) Mr. Mumm's analysis—which is focused on Otay's revenue requirements *not cost allocation*—does just that. As the HDR Report says: "the objectives of the cost of service analysis are different from determining a revenue requirement. As noted in the previous section, a revenue requirement analysis determines the utility's overall financial needs, while the cost of service analysis determines the fair and equitable manner to collect the revenue requirement." (AR006025.) By averaging fixed and volumetric charges across tiers, Mumm's goal seems to be to show that Otay's overall financial needs were met and were kept revenue neutral, but the key point of a cost of service analysis is allocation. But there is no denying that higher costs are allocated to higher tiers and thus higher consumption results in an inequitable allocation; Mumm's

graph appears to show the opposite: that customers pay more for water in the lower tiers because the fixed costs are the same for fewer units of water.

Second, Mr. Mumm's analysis undercuts Otay's sole justification for its ratemaking, and its core defense of its tiered-rate system, which is that the greater the volume of water delivered, the higher the cost. Mr. Mumm's analysis shows the opposite. (Mumm Report at 18.) Per Mr. Mumm, "[T]he cost per unit decreases (vertical axis) as the units of demand increase (horizontal axis). Because a portion of every customer's service is a fixed cost — in this case, $35.55 per month — the initial unit cost is high but decreases as the fixed cost is divided among more and more units as consumption increases." (Mumm Report at 17-18.) This suggests there is no difference in the cost of delivering higher volumes of water, and even that there may be some cost savings to customers who use more water, because as the number of units increases, the fixed costs are a smaller proportion of the total bill.

Third, Mumm's approach is also inconsistent with customers' experience – which is that they are charged more for water in higher tiers even though there is no cost basis for the increase. Mumm's analysis does not save Otay's rates because even if the fixed costs reflect the actual cost of service, Proposition 218 still requires Otay's volumetric rates to do so, too--and they do not. If anything, Mumm's graph suggests that volumetric costs do not change as the volume of water increases, which is consistent with how Otay sets rates for commercial and irrigation customer classes, and would support a flat rate for residential customers like Vondle proposes. (Vondle Report, ¶ 18.)

Fourth, Mumm's analysis is flawed because it is based on the same faulty assumptions as the HDR Report. Rather than proving that Otay's tiered rates are cost-based, Mumm's model makes a series of assumptions based on the HDR Report, and then works backwards to reach the desired result. Mumm assumes that that the number of tiers, and their breakpoints, are correct; that the cost allocations in HDR's peaking analysis are correct; and that HDR's peaking analysis, which is based on volume, not time, is correct. As explained above, each of these assumptions is unfounded and not supported by any data. Therefore, Mr. Mumm's approach does not show that HDR's cost allocation method is correct; it only shows that Mr. Mumm's cost allocation

methodology is the same as HDR's. Because both Mr. Mumm and HDR use the same flawed cost allocation to the peaking factor, *both are incorrect.*

Finally, Mumm's total-cost approach, and in large measure his discussion of peaking, is little more than post-hoc rationalization for Otay's action. Indeed, much of Mumm's discussion of peaking simply does not match the record and attempts to inject new, or beefed-up, rationales that were never presented to the public and were evidently not the basis for Otay's ratemaking. The same is true of his total-cost approach. In this Proposition 218 challenge, the Court cannot apply rational-basis review, whereby deference is owed to an agency and any conceivable basis for the agency's action may be considered. Proposition 218 requires that Otay present substantial evidence in the administrative record—a record that reflects the water district's public explanations for why its methodology complies with Proposition 218. The important values of promoting agency accountability to the public, instilling confidence that reasons given are not simply convenient litigating positions, and facilitating orderly review would be markedly undermined if the Court were to allow Otay to rely on reasons never previously articulated at public hearings mandated by the Constitution.

In sum, Mr. Mumm's analysis does not support the actual ratemaking Atkins or HDR performed and does not show that the rates Otay charged during the class period align with the actual costs of delivering service at those tiered levels.

C. The Court rejects Otay's arguments that it should not be held accountable under Proposition 218.

At trial, Otay suggested that it was being held to a standard of perfection. To the contrary, the Court has applied established constitutional standards. The record shows convincingly that Otay has not calculated the actual costs of providing water at various levels of usage. The Court cannot disregard its obligation to enforce Proposition 218, particularly when Otay's failures are the same failures that *Capistrano* and *Palmdale* identified.

///

///

///

Also at trial, Otay suggested that it should be given a pass, at least for 2013, because *Capistrano* was issued after Otay adopted rates in 2013. That suggestion makes little sense. *Capistrano* itself held a water district liable for ratemaking adopted circa 2010 because it failed to comply with Proposition 218. Unquestionably, then, Otay may be held to account for its 2013 ratemaking. Besides, Proposition 218 has required proportionality in ratemaking since 1996, and judicial interpretations of that law simply reflect what the law meant before as well as after. (*See McClung v. Employment Development Dept.* (2004) 34 Cal.4th 467, 474, 20 Cal.Rptr.3d 428, 99 P.3d 1015 ("'judicial construction of a statute is an authoritative statement of what the statute meant before as well as after the decision of the case giving rise to that construction.' [Citations.]".)

Lastly, Otay expressed a concern that a ruling against it would invite additional legal scrutiny of ratemaking in the form of lawsuits. The audience for that criticism are the citizens of California, not this Court. The voters enacted Proposition 218 to shift the burden to water districts and to demand substantial evidence of compliance precisely to "make it easier for taxpayers to win lawsuits." (*Silicon Valley, supra*, 44 Cal.4th at p. 448.) Put simply, the Constitution does not evince a concern that taxpayers will be overzealous in vindicating their constitutional rights, and the Court is bound by the Constitution.

For these reasons, the Court cannot excuse Otay's violation of Proposition 218.

V. Conclusion

After careful consideration of the parties' positions, the applicable burden of proof, binding case law, and an independent examination of the record, the Court concludes that Otay has failed to demonstrate by substantial evidence that its 2013 and 2017 tiered water rates were 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.

IT IS SO ORDERED

Dated: March 4, 2021

By: Eddie C. Sturgeon
Hon. Eddie Sturgeon
Superior Court Judge