Are Tiered Water Conservation Rates Legally Valid?

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In Florida, water utilities are required to adopt water-conserving rate structures as a condition for issuance of a consumptive use permit. Florida law grants utilities wide latitude in the rate structure adopted, as long as it promotes water conservation [§ 373.227(3), Fla. Stat.]. The conservation rates are typically tiered with increasing block rates based on water usage, with rates increasing in each tier to discourage high water use.

This type of rate structure is also used in other states, including California. However, a recent appellate decision in that state has forced water utilities there to radically reevaluate the use of tiered rates. On April 20, 2015, California's Fourth Appellate District issued an opinion in *Capistrano Taxpayers Ass'n, Inc. v. City of San Juan Capistrano*. In that case, a group of taxpayers filed a lawsuit against their water utility, alleging that its tiered rates violated a provision of the California Constitution, adopted by voters in 1996, known as Proposition 218 (see Cal. Const., art. XIII D, § 6).

Proposition 218 provides in relevant part that any "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." The court in *San Juan Capistrano* ruled that tiered water rates do not automatically violate the requirements of Proposition 218, but in order to be legal, the rate charged to customers must be shown to correspond to the actual cost of providing water to customers in each tier. In other words, basing rate tiers on amounts determined to be necessary to encourage efficient water usage violates Proposition 218, unless the utility can demonstrate that the cost of providing water to higher-consumption users is proportional to their water use.

The court in *San Juan Capistrano* also found that the limitations imposed by Proposition 218 apply equally to recycled (reclaimed) water. Therefore, the cost of implementing reclaimed water is subject to the same cost-based analysis, though the court did allow for the possibility that higher-consumption users could be charged higher rates, if it can be shown by the utility that the need for development of reclaimed water is attributable to users in the higher-rate tier.

Also of note, California's constitution contains a separate provision that specifically requires conservation and efficient use of water in the state (see Cal. Const., art. X, § 5). The *San Juan Capistrano* court, however, ruled that this provision of the constitution does not specifically address water utility rates, does not mandate that water-conserving rates be adopted, and does not trump the requirements of Proposition 218.

The utility in *San Juan Capistrano* calculated its water rates based on the American Water Works Association's *M1 Principles of Water Rates, Fees and Charges*. This guidance manual provides for utilities to calculate their various costs, differentiate between classes of water customers, and calculate water budgets for possible usage patterns based on assumptions about low, reasonable, excessive, and very excessive water use. Those water budgets formed the basis for the utility's four rate tiers. Under the ruling in *San Juan Capistrano*, this method of determining rates is invalid, since it relies on determinations of which levels of use are low, reasonable, or excessive to allocate costs. Instead, rate tiers must be based on an analysis of actual costs of providing service to the given customer. This could still allow for some consideration of the customer's actual use rate, but must tie that rate to actual costs. In other words, the utility must "show its work" to justify that its tiered rates comply with Proposition 218.

What are the implications of this ruling for Florida water utilities and their customers? Florida does not have a constitutional or statutory provision like Proposition 218. However, the sentiment that property owners need to be protected from ever-increasing fees and assessments, which led to the approval of Proposition 218 by California voters, is similar to that which led Florida voters to approve the 1992 "Save Our Homes" amendment, which caps the increase in assessed value of Florida homestead property. Furthermore, the issue of establishing a nexus and proportionality in relation to land use and imposition of fees was recently addressed by the U.S. Supreme Court in *Koontz v. St. Johns River Water Management District*. That case found that the monetary exactions required in the context of environmental permitting must meet the test of nexus and rough proportionality to be valid. Though *Koontz* does not specifically address the ability of governments to impose user fees such as utility rates on property owners, the rationale of that case is extremely similar to the *San Juan Capistrano* decision.

The reasoning reflected in the *San Juan Capistrano* decision should be proactively addressed by water utilities in Florida. Otherwise, water utilities may wake up one day to find the validity of tiered conservation rates in the hands of the state's courts.

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