



Newhall Case Applies Proposition 26 to Wholesale Water Rates

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Newhall County Water District v. Castaic Lake Water Agency (2016) 243 Cal.App.4th 1430 (Newhall)

Case Disposition

Plaintiff Newhall County Water District (Newhall), a retail water purveyor, challenged a wholesale water rate increase by Defendant Castaic Lake Water Agency (Castaic), a government entity that supplies imported water to four water retailers in the Santa Clarita Valley, including Newhall. (*Newhall, supra*, 243 Cal.App.4th at p. 1433.) Newhall argued, among other things, that Castaic's rate increase violated Article XIII C of the California Constitution (i.e., Proposition 26).¹ (*Id.* at p. 1440.) The increased rates were based in substantial part on Newhall's use of groundwater, which was not supplied by Castaic. (*Id.* at p. 1433.) The Court held that the rates violated Proposition 26 because the rates do not bear a fair or reasonable relationship to Newhall's burdens on, or benefits received from, [Castaic's] activity. (*Id.* at pp. 1433-1434, Cal. Const., art. XIII C, § 1, subd. (e), final par.)

Factual and Procedural Background

Castaic imports water, primarily from the State Water Project, and provides it to four retailers in the Santa Clarita Valley, including Newhall. (*Newhall, supra*, 243 Cal.App.4th at pp. 1433-1434.) Before Castaic increased its rates, it charged a volumetric rate (i.e., on per acre-foot basis) for the sale of imported water. (*Id.* at p. 1437.) Castaic's new rate structure included a fixed charge through which the agency would recover 80 percent of its costs. (*Id.* at p. 1438.) The fixed charge was based on each retailer's three-year rolling average of total water demand—including its demand for imported water and its demand for groundwater not supplied by Castaic. (*Ibid.*)

Newhall's demand for imported water varies from year to year. (*Newhall, supra*, 243 Cal.App.4th at pp. 1435-1436.) On average Newhall has obtained about 30 percent of its water supplies annually from Castaic, and Newhall satisfies the rest of its customers' needs by exercising its groundwater rights. (See *id.* at pp.

1434-1436.) Under the new rates, which are based heavily on demand for groundwater, Newhall's charges were expected to increase by 67 percent. (See *id.* at p. 1439.)

The other three retailers rely more heavily on imported water supplied by Castaic. (*Newhall, supra*, 243 Cal. App.4th at p. 1436.) Castaic owns or controls two of these retailers and, through them, supplies about 83 percent of water demand in the Santa Clarita Valley. (*Id.* at p. 1434.)

Newhall contended in its lawsuit that Castaic's new rates are not proportionate to Newhall's benefits from, and burdens on, the service provided by Castaic. (*Newhall, supra*, 243 Cal.App.4th at p. 1440.) Castaic argued that since all retailers benefit from the availability of imported water, they should pay for the fixed costs of the system in proportion to the demand or burden they place on the total water supply, regardless of how they utilize individual sources of supply. (*Id.* at pp. 1438-1439.) The Court rejected Castaic's position, holding that Castaic cannot, consistent with Proposition 26, base its wholesale water rates upon the retailers' use of groundwater, which Castaic does not supply. (*Id.* at p. 1441.)

Proposition 26

Proposition 26 was adopted in 2010, and it expands the definition of a tax which is subject to voter approval under Article XIII C, Section 2 of the California Constitution. Under Proposition 26, a tax now includes any levy, charge, or exaction of any kind imposed by a local government, with seven exceptions. (Cal. Const., art. XIII C, § 1, subd. (e).) The relevant exception in *Newhall* is that a charge is not a tax if it is *imposed for a specific government service or product provided directly to the payor that is not provided to those not charged*, and which does not exceed the reasonable costs to the local government of providing the service or product. (*Id.* at § 1, subd. (e)(2) [emphasis added].) The agency seeking to impose such a charge bears the burden of proving by a preponderance of the evidence that its charge is not a tax, that the amount is no more than necessary to cover the reasonable costs of the governmental activity, and that the *manner in which those costs are allocated to a payor bear a fair or reasonable relationship to the payor's burdens on, or benefits received from, the governmental activity.* (*Id.* at § 1, subd. (e), final par [emphasis added].)

Discussion

The Court held that Castaic's rate increase violated Proposition 26 in two ways. First, the new rate structure violates the proportionality requirement in that it does not bear a fair or reasonable relationship to the payor's burdens on, or benefits received from Castaic's activity. (*Newhall, supra*, 243 Cal.App.4th at p. 1441.) Second, to the extent Castaic seeks to justify its rates based on the benefit to retailers from Castaic's groundwater management activities, this benefit is too indirect and cannot be characterized as a service . . . provided directly to the payor that is not provided to those not charged. (*Ibid.*, quoting Cal. Const., art. XIII C, § 1, subd. (e)(2).) The main problem identified by the Court is that Castaic's rates are based on the use of groundwater, which Castaic neither supplies nor regulates.

The Court rejected Castaic's argument that it may include the demand for groundwater in its rate structure because the proportionality requirement is measured collectively, not by the burdens on or benefits to the individual retailer. (*Newhall, supra*, 243 Cal.App.4th at p. 1442.) The Court dismissed Castaic's analogy to *Griffith v. City of Santa Cruz* (2012) 207 Cal.App.4th 982 (*Griffith I*) and *Griffith v. Pajaro Valley Water Management Agency* (2013) 220 Cal.App.4th 586 (*Griffith II*). The Court reasoned that *Griffith I* involved a different exemption from Proposition 26 for regulatory fees (*Newhall, supra*, 243 Cal.App.4th at 1442-1443), and *Griffith II* was decided under Proposition 218, not Proposition 26. (See *id.* at pp. 1444-1447 [discussing *Griffith II* at length].) The Court concluded that where charges for a government service or product are allocated among four payors, the only rational method of evaluating their burdens on, or benefits received

from, the governmental activity, is individually, payor by payor. (*Id.* at p. 1444.)

The Court also rejected the argument that Castaic's rates can be justified because Castaic has a role in managing local water supplies, much like the defendant agency in *Griffith II*. (See *Newhall, supra*, 243 Cal. App.4th at pp. 1446-1447.) The Court explained that in *Griffith II*, the defendant agency was created to manage all water resources, whereas Castaic was created merely to acquire water and to provide, sell, and deliver it. (*Id.* at 1447.) According to the Court's analysis, although Castaic spearheaded the preparation of a local groundwater management plan, Castaic lacks comprehensive authority to manage the basin's resources. (*Id.* at pp. 1436-1437, 1447.) Further, groundwater management activities are not a service . . . provided directly to the payor that is not provided to those not charged. (*Id.* at pp. 1441, 1451, quoting Cal. Const., art. XIII C, § 1, subd. (e).) Whereas the agency in *Griffith II* is empowered to levy groundwater extraction charges, Castaic does not have this power. (*Newhall, supra*, 243 Cal.App.4th at p. 1447.) The Court concluded that *Griffith II* does not support charging users for a product or service that Castaic does not supply. (*Id.* at pp. 1441, 1442, 1446.)

Finally, the Court dismissed the notion that Castaic's rates are justified by the conservation mandate embodied in Article X, Section 2 of the California Constitution. (See *Newhall, supra*, 243 Cal.App.4th at pp. 1448-1450.) The Court cited a 2015 case, *Capistrano Taxpayers Assn., Inc. v. City of San Juan Capistrano* (2015) 235 Cal.App.4th 1493, which rejected a similar argument made in the context of Proposition 218. (*Newhall, supra*, 243 Cal.App.4th at pp. 1446, 1459.) Much like *Capistrano Taxpayers Assn.*, *Newhall* held that the conservation mandate cannot be read to eliminate Proposition 26's proportionality requirement. (*Id.* at p. 1449.)

Conclusion

Numerous recent appellate court opinions interpret and apply Proposition 218 and/or Proposition 26 in the context of evaluating the validity of water-related fees and charges. *Newhall* provides yet another benchmark for water purveyors to keep in mind when evaluating whether rate structures comply with Constitutional requirements.

¹ *Newhall* also argued that the rates violated Proposition 13, Government Code section 54999.7, and the common law of utility ratemaking. (*Newhall, supra*, 243 Cal.App.4th at 1440.) The appellate court disposed of the matter on Proposition 26 grounds; therefore, we do not address these other bases which were passed on by the trial court.

² Even though *Newhall* insists that these distinctions . . . do make a difference, the Court's analysis does not clearly dismiss the idea that the proportionality analysis may be similar under Proposition 218 and the various exceptions to Proposition 26. (See *Newhall, supra*, 243 Cal.App.4th at pp. 1442-1447.)