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Exempt from Filing Fees
Government Code § 6103

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

Citizens for Fair REU Rates, et al.
Plaintiffs and Appellants

vs.

City of Redding, et al.
Defendants and Respondents.

SUPREME COURT
FILED

MAR 3 - 2015

Fee Fighter LLC, et al.
Plaintiffs and Appellants

vs.

City of Redding, et al.
Defendants and Respondents.

Frank A. McGuire Clerk

Deputy

**MOTION FOR JUDICIAL NOTICE
IN SUPPORT OF PETITION FOR REVIEW
VOLUME II OF III**

Of a Published Decision of the
Third Appellate District, Case No. C071906

Reversing a Judgment of the Superior Court of
the State of California for the County of Shasta,
Case No. 171377 (Consolidated with Case No. 172960)
Honorable William D. Gallagher, Judge Presiding

*MICHAEL G. COLANTUONO (143551)

MColantuono@chwlaw.us

AMY C. SPARROW (191597)

ASparrow@chwlaw.us

MICHAEL R. COBDEN (262087)

MCobden@chwlaw.us

COLANTUONO, HIGHSMITH & WHATLEY, PC

11364 Pleasant Valley Road

Penn Valley, California 95946-9000

Telephone: (530) 432-7357

Facsimile: (530) 432-7356

Attorneys for Respondent City of Redding

EXHIBIT D

Exempt from Filing Fees
Government Code § 6103

Case No. G048969

In the Court of Appeal, State of California
FOURTH APPELLATE DISTRICT, DIVISION THREE

COURT OF APPEAL-4TH DIST DIV 3
FILED

CAPISTRANO TAXPAYERS ASSOCIATION, INC., JAN 16 2014
Plaintiff and Respondent

vs.

Deputy Clerk _____

CITY OF SAN JUAN CAPISTRANO,
Defendant and Appellant

Appeal from the Superior Court of the State of California
County of Orange, Case No. 30-2012-00594579
Honorable Gregory Muñoz, Judge Presiding

PURSUANT TO RULE 8.25(b)(3)
CALIFORNIA RULES OF COURT
CONSTRUCTIVELY FILED
1-14-14

DEPUTY CLERK

APPELLANT'S OPENING BRIEF

Michael G. Colantuono (143551)
*Tiana J. Murillo (255259)
Jon di Cristina (282278)
COLANTUONO & LEVIN, PC
300 S. Grand Avenue, Suite 2700
Los Angeles, California 90071-3137
Telephone: (213) 542-5700
Facsimile: (213) 542-5710
TMurillo@CLLAW.US

Hans Van Ligten, City Attorney
Joel Kuperberg (90248)
City of San Juan Capistrano
RUTAN & TUCKER, LLP
611 Anton Blvd., Ste. 1400
Costa Mesa, CA 92626-1931
T: (714) 641-5100
F: (714) 546-9035
JKuperberg@rutan.com

Attorneys for APPELLANT CITY OF SAN JUAN CAPISTRANO

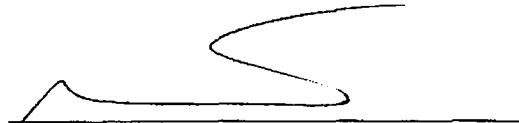
CERTIFICATE OF INTERESTED ENTITIES OR PERSONS

The following entities or persons have either (1) an ownership interest of 10 percent or more in the party or parties filing this certificate or (2) a financial or other interest in the outcome of the proceeding that the justices should consider in determining whether to disqualify themselves:

None.

DATED: January 14, 2014

COLANTUONO & LEVIN, PC



MICHAEL G. COLANTUONO

TIANA J. MURILLO

JON di CRISTINA

Attorneys for Defendant and Appellant

CITY OF SAN JUAN CAPISTRANO

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INTRODUCTION

This case requires this Court to harmonize three constitutional principles: the requirement of article XIII D,¹ section 6 (Proposition 218) that water rates be proportional to service cost; article X, section 2's mandate that water not be wasted; and municipal power under article XIII C, section 1, subdivision (e)(5) and article XI, section 7 to penalize water waste. Specifically, the City of San Juan Capistrano ("City") appeals three findings for the Capistrano Taxpayers Association ("CTA") in this challenge to water rates the City adopted in 2010:

1. The trial court found "no evidence" in a lengthy and detailed administrative record to support distinctions among the rates' tiers, which charge progressively more per unit as water use grows from efficient to budgeted to wasteful. (4 CT 1159-1160.) The trial court therefore erroneously concluded the rates violate article XIII D, section 6, subdivision (b)(3)'s requirement that fees "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." (*Ibid.*)

¹All references to "articles" in this brief are to the California Constitution.

2. The trial court ruled under article XIII D, section 6, subdivision (b)(4) that the City may not fund its proposed recycled water service from domestic water rates because recycled water is not yet “immediately available” to domestic customers. (4 CT 1160.)
3. The trial court stated Tiers 3 and 4 rates for over-budget water use are “not penalties” — a terse finding which might be factual or legal, but is error in either case. (4 CT 1161.)

As to the first finding, the Administrative Record includes scores of documents supporting the rates. These include a Rate Model and Rate Study using audited financial data to relate price tiers to water supply cost. This is far more than “no evidence” and entirely sufficient to demonstrate compliance with Proposition 218.

The second finding reflects two fundamental errors. First, as a matter of fact, the City’s potable rates include no costs of the recycled water system: the trial court misread dense accounting tables which calculate the share of the water utility’s general overhead that will be assigned to recycled water customers in the future as though they were costs that must be assigned to non-existent recycled water customers² now. Moreover, even if the City

²The record reflects the City’s reasonable estimate in 2010 that it would not have a meaningful number of recycled water customers before fiscal year 2012–2013. Rate Study Table 1 shows zero recycled

did charge domestic customers costs of a nascent recycled water service, providing recycled water lowers the cost to supply potable water to those domestic customers just as conservation does and it is appropriate to charge them for that supply. Specifically, by freeing up potable water used for irrigation, the recycled water program will provide additional supplies to all customers more cheaply than increased reliance on imports through the environmentally sensitive Sacramento-San Joaquin Delta.

Still further, the trial court's conclusion requires utilities either to (i) blend all sources of water prior to delivery if they desire utility-wide rates, or (ii) set distinct rates for each source. This is impracticable given the multiple sources utilities maintain to ensure reliable supplies and frequent changes in use of sources.

Whether the "not penalties" finding is factual or legal, it is error. The City's water rates employ four tiers, with Tiers 3 and 4 intended— and justifiable— as penalties not subject to a cost limit. Moreover, this record shows they relate to service cost in any event.

water accounts before 2013, but shows customers moving from the landscape and non-potable classes to that class in that year. (19 AR 4591; 4592 ["The projected revenues shown in the Table 4 reflect[] conversion of landscaping and non-potable water customers to recycled water in FY12/13."].) That prediction proved overly optimistic; the City presently has 10 recycled water customers, none of them residential.

These errors invade the City Council's lawful discretion to operate an efficient and environmentally sound utility consistently with Proposition 218's cost-of-service principle and article X, section 2's conservation imperative.

Accordingly, the City urges this Court to reverse and to grant declaratory relief consistent with the law described here.

STATEMENT OF FACTS

I. THE CITY HAS RELIED ON CONSERVATION RATES SINCE 1991

During the 1989-1992 drought, the State Water Project cut deliveries 20 percent. (15 AR 3385.)³ Those affected included the Metropolitan Water District of Southern California ("Met"), which delivers imported water to the City via the Municipal Water District of Orange County ("MWDOC").⁴ (See *ibid.*; 17 AR 4138.) Met in turn "required all [its] member agencies to reduce demand by 30% or face surcharges and possibly curtailment of supply." (17 AR 4138.)

Rather than ration water — as other utilities did — the City adopted the tiered water rate structure it maintains today. (11 AR

³References to the Administrative Record are in this form: "volume AR page."

⁴For convenience, this brief refers to MWDOC and Met collectively as "Met."

2768 [AWWA Research Foundation paper]; 15 AR 3310 [workshop slides], 3385–3386 [Met-funded study of landscape water conservation].)

Even in 1991, it was a best management practice “to establish a strong nexus between volume-related system costs and volumetric commodity rates,” a practice since endorsed by statute. (17 AR 3935, 3985–3986 [1991 California Urban Water Conservation Council MOU]; see Wat. Code, § 10608.4, subd. (f) [endorsing CUWCC best management practices].) Indeed, the City is a leader in use of budget-based conservation rates. (See 18 AR 4278 [City achieves “substantial conservation”]; 17 AR 4137 [“One of the most mature water budget rate structure programs in the country has been implemented in the City of San Juan Capistrano since 1991.”].)

II. PRESSURE TO CONSERVE HAS INTENSIFIED

The imperative to reduce water use has grown since 1991, even before the current, three-years-and-counting drought. The Legislature’s “20x2020” mandate requires the City to reduce per capita water consumption by 20 percent by 2020. (See Wat. Code, § 10608.16.) This is measured from average consumption in the decade ended 2004, and thus demands more of the City — which made serious conservation efforts earlier — than of others. (*Ibid.*, § 10608.12, subd. (b) [defining “base daily per capita water use”].)

The Grand Jury recently warned of a “looming water crisis” threatening Met deliveries. (11 AR 2752, 2755.)

When the City adopted the rates challenged here in February 2010, the non-penalty rate for Met supplies was \$701 per acre-foot (“AF”), but the City knew it would increase substantially. (18 AR 4446; 19 AR 4508.) It did. Effective January 1, 2014, Met’s non-penalty rate is \$890 / AF — a 27 percent increase in four years.⁵ Moreover, Met imposes penalty rates on retailers which exceed consumption budgets just as the City penalizes residents who do. (See 18 AR 4446, 4459–4493.) Met penalty rates in 2010 were \$1,899 and \$3,077 / AF. (18 AR 4446.)

The City therefore has strong incentive to reduce demand and decrease imports from Met. Its rates must cover their high and increasing cost. Accordingly, the rates challenged here:

- Maintain a tiered structure to reduce demand and to fund expensive Met supplies to meet demand in excess of water budgets; and
- Propose a new recycled water program to be funded by grants and rates on recycled water customers. The program will free potable supplies for others, reducing dependence on expensive and unsustainable Delta imports. This

⁵Met Adopted Rates & Charges, available at <www.mwdh2o.com/mwdh2o/pages/finance/finance_03.html> (as of Jan. 12, 2014).

program did not exist when the City adopted water rates in February 2010 but was proposed to commence in 2012–2013. (See 13 AR 3164 [“No Recycled Water Accounts in FY 09/10”]; 19 AR 4591, 4592, 4594⁶ [projecting recycled water accounts, sales and revenue beginning FY 12/13].) The City expected grants to cover many of the start-up costs for the program. (See 19 AR 4605 [Rate Study: “Some of the CIP [Capital Improvement Plan] needs are offset by the potential receipt of recycled water grants.”], 4598 [lines 16–25 list recycled water improvements to be grant funded].) It also intended to issue debt to be repaid from recycled water rates (See 19 AR 4597.) That bond did not issue. (4 CT 1081–1084.)

III. THE RATES DREW LITTLE OPPOSITION

Neither CTA nor the trial court questions the City’s compliance with Proposition 218’s procedural requirements. (Art. XIII D, § 6, subd. (a).) The City mailed notices of a protest hearing to its 15,089 customers, advising them of the opportunity to protest the rates. (20 AR 5005–5006.) If a majority did so, Proposition 218 would bar adoption of the rates. (Art. XIII D, § 6, subd. (a)(2).)

⁶ For the convenience of the Court, the most central pages of the Administrative Record are attached to this Brief pursuant to California Rules of Court, rule 8.204, subdivision (d). Citations to those attached pages are **boldface**.

However, just 23 customers protested. (20 AR 5006.) The City Council therefore adopted the rates challenged here. (20 AR 5004–5010.)

IV. THE RATES COMPLY WITH INDUSTRY STANDARDS AND REFLECT SERVICE COST

The dearth of opposition to the City's rates supports the observation that budget-based rates are "an intrinsically more equitable way of charging water rates" than other methods. (18 AR 4270, 4278 [AWWA Journal].) Indeed, the City's tiered rates are popular with residents. (17 AR 4137 [AWWA Research Foundation paper].) Moreover, they are consistent with industry best practices and proportional service cost.

A. THE CITY FOLLOWED THE INDUSTRY-STANDARD M1 MANUAL

The American Water Works Association's Principles of Water Rates, Fees, and Charges (the "M1 Manual") is the industry standard for rate-making, endorsed by the Court of Appeal as compliant with Proposition 218. (20 AR 4794–4975;⁷ *Griffith v. Pajaro Valley Water Mgmt. Agency* (2013) 220 Cal.App.4th 586, 600–601 [petn. for review pending] ("*Griffith*").) The first step in rate-making under the M1 Manual is to determine a utility's "revenue requirement" — the

⁷The sixth edition is dated 2012. The Administrative Record includes the edition available in 2010 — the fifth edition, dated 2000.

difference between projected operating costs and non-rate revenues.
(See 20 AR 4805 et seq.; *Griffith, supra*, 220 Cal.App.4th at p. 600.)

The second step is “cost allocation”, by which a utility distributes costs among customer classes “commensurate with their service requirements.” (20 AR 4829; *Griffith, supra*, 220 Cal.App.4th at pp. 600–601 [calling this “apportionment”].) The M1 Manual notes:

The ideal solution to developing rates for water utility customers is to assign cost responsibility to each individual customer served and to develop rates to derive that cost. Unfortunately, it is neither economically practical nor often possible to determine the cost responsibility and applicable rates for each individual customer served. However, the cost of providing service can reasonably be determined for groups or classes of customers that have similar water-use characteristics and for special customers having unusual water-use or service requirements.

(20 AR 4836; see *California Farm Bureau Federation v. State Water Resources Control Bd.* (2011) 51 Cal.4th 421, 438 [“The question of proportionality [under Prop. 13] is not measured on an individual basis. Rather, it is measured collectively, considering all rate payors.”] (*Farm Bureau*); *Griffith, supra*, 220 Cal.App.4th at p. 601 [same for Prop. 218].)

To allocate costs pursuant to the M1 Manual, therefore, a utility identifies classes of customers with common service characteristics and costs. (See 20 AR 4836–4839; *Griffith, supra*, 220 Cal.App.4th at p. 601 [“Given that Proposition 218 prescribes no particular method for apportioning a fee or charge other than the amount shall not exceed the proportional cost of the service attributable to the parcel, defendant’s method of grouping similar users together for the same augmentation rate and charging the users according to usage is a reasonable way to apportion the cost of service.”].)

A utility then identifies its essential functions (e.g.; metering; billing; supply, transmission, treatment; maintenance; etc.), accounts the costs of each, and allocates these costs among customer classes in proportion to their benefit from or burden on each function. (See 20 AR 4829–4842.)⁸ For example, because residential customers make more demands on billing and answering telephone inquiries than do others, the residential class bears a larger share of customer-service costs. (See 19 AR 4612 [Rate Study, Table 13, column 8, lines 3 & 5]; 20 AR 4836–4837, 4838.)

The third step is “rate design,” which the M1 Manual describes as “a function of many diverse and sometimes competing

⁸*Griffith* conflates “functionalizing costs” [i.e., allocating cost functions] and allocating them to customer classes as “apportionment.” (220 Cal.App.4th at pp. 600–601.)

objectives.” (20 AR 4844.) Accordingly, rate design is discretionary and legislative. (See *Pacific Telephone & Telegraph Co. v. Public Utilities Com.* (1965) 62 Cal.2d 634, 655 (PT&T).) There is no one right answer and the M1 Manual therefore identifies options. (See 20 AR 4843 et seq.)

The City employs “increasing block rates,” as to which the M1 Manual states:

Increasing block rate structures, when properly designed and differentiated by customer class, allow the utility to send consistent price signals to customers without overearning or underearning. For this reason, and the heightened interest in water conservation, increasing block rates have been increasingly favored, especially in relatively water-scarce regions.

(20 AR 4855.) The Court of Appeal found such rates reasonably related to service costs and therefore not special taxes requiring voter approval under Proposition 13. (*Brydon v. East Bay Mun. Utility Dist.* (1994) 24 Cal.App.4th 178, 182, 196 (“*Brydon*”).)⁹

In 2009, consultant Black & Veatch prepared a cost of service study (the “Rate Study”) for the City. (19 AR 4568–4681.) Black &

⁹The M1 Manual and this record refer to “increasing-block” rates, while *Brydon* refers to “inclining-block” rates. The terms are synonymous. (20AR 4854 [“Increasing block rates [are] also known as ascending, inclining or inverted block rates.”])

Veatch followed the M1 Manual, and the Rate Study's "basic methodology" is its three-step process: revenue requirement, cost allocation,¹⁰ and rate design. (19 AR 4588.) The Rate Study recommended the rates which CTA challenges here. (19 AR 4617; 20 AR 5004-5010.)

B. THE RATES ARE PROPORTIONAL TO COST

Underlying the Rate Study is a complex spreadsheet (the "Rate Model") Black & Veatch used to develop the challenged rates. (19 AR 4682-4793.) The 111-page Rate Model is essential evidence supporting the rates. It projects the City's operating costs and revenues from 2009-2010 to 2013-2014, although rates were adopted for 2010-2013. (20 AR 5008-5010.) The model begins with audited financial records of operating costs and revenues to determine revenue requirements; allocates costs among customer classes; and calculates rates to recover those costs. As detailed below, the trial court's conclusion "no evidence" supports the City's rates (4 CT 1159-1160) is error.

The Rate Model first reports data from the utility's audited financial records. It reports the utility's operational data, including:

¹⁰The Rate Study identifies the second step as "Cost of Service," but defines it as the M1 Manual defines "Cost Allocation." (Compare 19 AR 4588 with 20 AR 4829.)

- current cash position (19 AR 4684),
- customers' net irrigable area (*ibid.*),
- indoor water allocations (19 AR 4685),
- evapotranspiration ("EVO") factors to budget use in light of weather (*ibid.*),
- estimated growth in customers and service costs by budget line (19 AR 4686), and
- demand estimates, including "equivalency factors," which express use by non-residential customers as fractions or multiples of use by single-family residences (19 AR 4687).

To evaluate then-existing rates, the Rate Model analyzes actual utility expenses from 2008–2010. (19 AR 4690–4699 ["historic and Current Budget Line Items"].) It projects expenses through 2018, including debt payments through 2035. (19 AR 4700–4708 ["Project Revenue Requirements"]; 19 AR 4711 ["Annual Debt Service Requirements"].)

The Rate Model next analyzes data on customer classes, including billing frequency, number of customers ("connections") and consumption. (19 AR 4713–4740 ["Customer Connections and Service Characteristics"].) It projects revenues through 2018 under then-existing rates. (Compare 19 AR 4744–4746 [Rate Model] with 19 AR 4594 [Rate Study: "Table 4 — Revenues Under Existing Rates"].)¹¹ Based on City capital improvement plans, the Rate Model

¹¹ The Rate Study explains tables drawn from the Rate Model.

estimates costs to expand the Groundwater Recovery Plant and build a recycled water facility (Advanced Water Treatment plant ["AWT"]). (19 AR 4747 ["Capital Improvement Plan"].) The Rate Model next projects asset changes through 2018 resulting from increased rates. (19 AR 4748–4755 ["10-Year Projected Operating Results"].)

The Rate Model next analyzes water use by customer class. (19 AR 4757 ["Units of Service"] [compare Rate Study at 19 AR 4610].) It calculates the cost of service in 2010 from audited financial records and allocates it among customer classes. (19 AR 4758–4759 ["Determination of Water System Cost of Service (2010 Test Year)"] [compare Rate Study at 19 AR 4606], 4760–4761 ["Distribution of Water System Cost of Service (2010 Test Year)"] [compare Rate Study at 19 AR 4612].)

The Model adjusts initial allocations to reallocate to all customers costs that can be assigned to recycled water users when they exist. (19 AR 4762 ["Reallocation of Beneficial Use Categories"] [compare Rate Study at 19 AR 4613] ["Table 14–Comparison of Adjusted Cost of Service with Revenue under Existing Rates"].) Thus, recycled water costs currently allocated to potable water customers represent prospective rate relief to those customers: as recycled water customers come on-line, they will absorb a share of general costs borne till then by existing customers in all classes. This essential point is detailed in Section V.A. below.

The Rate Model next analyzes the rates in issue here. (19 AR 4763–4765 [compare Rate Study at 19 AR 4617].) It projects the effect of these rates on assets and organizes data from preceding pages. (19 AR 4766–4783 [compare 19 AR 4591–4592, 4594, 4596, 4598–4599, 4601–4602, 4606, 4608, 4610, 4611–4613, 4617, 4619].)

Crucially, the Rate Model plainly identifies the basis to allocate costs among rate tiers. It allocates costs of progressively more expensive water sources to progressively less efficient consumers to reward conservation and discourage waste. (See Section V below.) In an analysis entitled “Buildup of Rates” (19 AR 4709–4710), it proposes rates (red figures) slightly above those produced by dividing projected costs by historic sales (black figures) because increasing rates reduces sales. So, for example, the proposed Tier 1 rate for the most efficient water use by single-family-residential (SFR) customers with 5/8-inch meters is \$2.47 / CCF¹² rather than the \$2.41 produced by dividing projected costs by historic sales. (19 AR 4709.) This adjustment reflects the City’s twenty-year history – and its rate-making consultant’s professional experience – with the conservation impact of higher rates. (See 11 AR 2768 [City implemented conservation rates in 1991]; 20 AR 4883–4885 [M1 Manual chapter on price impact on water demand].)

¹²CCF means one hundred cubic feet – 748 gallons. (*Brydon, supra*, 24 Cal.App.4th at p. 184.)

C. THE CITY MAINTAINS THE 1991 TIERED STRUCTURE

Before adopting the rates challenged here, the City used three tiers rather than four. Residential tiers were:

- Tier 1: Up to an average total of 20 CCF,¹³ reflecting budgets of:
 - Indoor: 9 CCF.
 - Outdoor: Varies based on lot size and weather.
- Tier 2: Up to twice Tier 1. An initial penalty rate for those who exceed budget by up to 100 percent.
- Tier 3: All usage above Tier 2. A second penalty for the most inefficient consumers who exceed budget by more than 100 percent.

(14 AR 3227 [Nov. 17, 2009 staff report]; 15 AR 3318 [Dec. 2009 & Jan. 2010 workshop slides].)

The February 2010 rates divided the first tier into a low-volume tier for very efficient users (households with little outdoor use) and an average-volume tier for the balance of the previous first-tier budget:

¹³The City establishes water budgets for each parcel depending on its size and number of units and daily weather. For simplicity, this brief discusses only the budget for an average parcel in typical weather.