



A White Paper on Use of Water Fine and Penalty Revenue

Produced in Conjunction with Rutan & Tucker
for the ACC-OC Water Committee

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The following outlines potential approaches, strategies, constraints and opportunities to utilize funds from water penalties or fines. This white paper was requested by ACC-OC member cities to help identify how to responsibly and effectively utilize these resources for the benefit of taxpayers.

Background & Context

On April 1, 2015, Governor Jerry Brown issued Executive Order B-29-15 in response to California's years-long drought, imposing a State-wide 25% reduction in potable urban water use through February 2016. The Governor directed that the State Water Resources Control Board ("State Board") implement this conservation cutback through restrictions on individual retail water purveyors. In response, the State Board promulgated emergency regulations requiring each potable water purveyor to reduce deliveries from 8% to 36%. Both the Governor and the State Board have recommended drought-response tactics to conserve water, including the adoption of tiered rate structures' a number of cities and water agencies have also adopted penalty ordinances and enforced and collected fines for excessive water use.

Many cities and districts have adopted and enforced penalty structures, and collected significant conservation penalty revenue from these fines, which range from \$10 to upwards of \$10,000. Cities are now exploring ways to expend these resources responsibly and fairly.

At the request of these cities, the ACC-OC and Rutan & Tucker have prepared this brief whitepaper on how agencies can use water conservation penalty funds in compliance with the law and for a positive impact for your communities.

By way of background, tiered water rates and water conservation penalties are two different mechanisms to discourage excessive water use. A tiered water rate structure is an escalating set of water rate tiers, with increasing levels of water use triggering increasingly higher water rates. Because higher water usage results in higher per-unit water charges, the tiered rate structure serves as a disincentive pricing tool. Unlike water conservation penalties, tiered water rates do not assume that excess water use is illegal or "bad." Rather, the tiered water structure is an economic mechanism to require those who either use

excessive water and fail to conserve to pay proportionately more than those who do conserve. In the recent *San Juan Capistrano* case, the Court of Appeal held that tiered rate structures violate Proposition 218 (Article XIII D of the California Constitution) to the extent that rate tiers exceed the proportional cost of the water service attributable to individual parcels or customers. In order for tiered rates to comply with Proposition 218, the Court held that the rate structure must both tie the rate in each tier to the cost of providing that increment of water to the customer, and demonstrate how each tier rate relates to the cost of the water in that tier. Many cities and districts may find it difficult to adopt constitutional tiered conservation water rates structures in light of the *San Juan Capistrano* court decision.

Water conservation penalties are distinct from tiered water rate structures. Water conservation penalties are used to enforce violations of local city ordinances or water agency regulations, and impose fines to penalize and disincentivize illegal conduct--violations of the ordinance or regulation. Unlike tiered rates, which are imposed for lawful but excessive water use, a penalty cannot be imposed unless a law is violated. And, unlike revenues from tiered rates, the revenue that is derived from the penalty is not needed to cover the basic cost of providing the service; under a penalty structure, the city or water district is capable of foregoing the penalty revenue if the customer does not violate the ordinance or regulation and incur the penalty.

True penalties are not taxes or rates under Proposition 218, and are an exception to the definition of “taxes” under Proposition 26, which was passed by California’s voters in 2010. So long as a penalty is imposed as a violation of a local law or ordinance, the penalty need not be tied to the cost of providing service or any other local governmental cost. However, with regard to water, at least, many cities and agencies have found that it is more politically acceptable and better public policy to use water conservation penalty revenue for water-related services and activities that either reduce excessive water use or improve water service. The following outlines several of these options.

Potential Uses of Fines and Penalties

Capital Improvements

Revenue collected can augment capital improvement projects related to water service, including new projects, maintenance, retrofit or replacement. However, cities must weigh the relatively small amount of revenue collected from fines versus the comparative high cost of capital improvements. In most instances, fine revenue would have limited effect on overall budgets.

Pro: Easy transfer of funds for existing programs

Con: Limited impact to overall budget or water use efficiency

Water Use Efficiency Improvements

Technology varies from city to city. Some have irrigation systems installed more than 25 years ago. Technological advances have greatly reduced the cost of intelligent irrigation systems, while significantly expanding their impact. Cities should conduct audits of their

existing systems, then explore replacing or retrofitting irrigation technology. Rebates for these systems expand the value of fine revenue by a margin of nearly 2:1. Cities are encouraged to work with the ACC-OC and MWDOC on rebate eligibility and best available technology. Similar efforts can be done with turf replacement in medians or parkways. However, rebates for turf replacement are current exhausted.

Pro: High water savings potential; increases value of funds through rebates (upwards of 50%); adheres to state and regional guidelines encouraging increased technology usage

Con: Can add cost

Education

Countywide and regional educational efforts are underway to help sustain long-term changes to water use behavior. Some of these programs are funded by cities and water agencies. Fines and revenues could be used to bolster these efforts in your local community. A city or agency could also augment its own outreach budget with these funds to increase conservation and water use efficiency efforts within its boundaries. Examples could be a targeted advertising campaign, digital efforts (e.g. conservation website), or funding for regional outreach efforts and sponsorships. Regional partnerships with the Discovery Science Center or others may also be an option to further the value of investment.

Pro: Increased awareness; community goodwill

Con: Limited impact without sustained effort

Scholarships

When fine/penalty revenue is limited, a simple and goodwill gesture is to establish a scholarship program for local youth. While it must be water or conservation related, it is a positive solution that can advance knowledge and awareness in your communities. Acceptable and common levels of scholarships range from \$500-\$10,000.

Pro: Great community goodwill; ideal when limited funds available

Con: Benefits very few individuals; no immediate water conservation impact

Regulatory Compliance & Stormwater

While not directly related to water supply and delivery, fines can be used for compliance, including staff/consultant costs, outreach or other costs, related to some regulatory matters, including stormwater management. Municipal Separate Sewer & Stormwater Systems (MS4 permits) can be costly to implement. While funding compliance and permit monitoring may not be advisable, outreach and education to stormwater stakeholders (a requirement of MS4 permits) assists in the overall health of the water system and may be a justifiable use of these funds. Cities are encouraged to work with the ACC-OC and County of Orange on outreach efforts.

Pro: Helps fund unfunded state/federal mandates

Con: Limited impact on water use reduction; focused on stormwater

Direct Customer Re-investment

It is also possible to re-invest fine revenue directly back to those who were in violation. Irrigation devices, education, training or landscape renovations for those consistently out of compliance can help reduce the amount of accounts that waste water. However, this solution is not without perception challenges. Funding, in part, efforts for those in violation can be perceived as a poor use of funds.

Pro: Targets repeat offenders to gain compliance; works to earn 100% compliance

Con: Rewards bad behavior; perception challenges

Supplemental Rebate/Fee Waiver Programs

Funds can be used to develop your own rebate program. These rebates can augment existing rebates from other agencies, like Met or MWDOC. They can also be used to waive fees or costs associated with installing water-saving infrastructure or devices otherwise not eligible for rebates. For example, the City of Mission Viejo has waived all fees related to water saving efforts. Funds from fines could be used to backfill the lost revenue as a result of this waiver.

Pro: Incentives action; builds community goodwill; equitable

Con: Benefits those who apply; limited funds

Cost of Service – The Absolute Truth

The aforementioned programs have one common thread: they are all directly related to the cost of service to deliver, manage, treat and/or manage water. This is called “cost of service” and it is critical to water policy, law and rates. The use of fines and penalties must relate back to cost of service. Period.