

RANCHO SANTA FE ASSOCIATION (RSFA) TALKING POINTS FOR CRITICAL REVIEW OF PROPOSED CAROLLO NOVEMBER 2019 COST OF SERVICE WATER RATES STUDY (COSS) SUBMITTED TO SFID BOARD OF DIRECTORS

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Five-Tier Rate Structure: Conclusion

The Proposed Five-Tier Rate Structure for Single Family Residential Class (SFR) users prepared by Carollo Engineers, if adopted, will result in significant inequities for SFR customers with relatively large water needs.

- Inequitable rates either overcharge or undercharge the respective residential customer from a cost of service viewpoint.
- Therefore, the proposed SFR rates do not comply with industry standards as found in American Water Works Association **Principles of Water Rates, Fees, and Charges**, 2012 and 2017 or M1 Manual, and AWWA **Water Rates, Fees, and the Legal Environment, Second Edition 2010** (The second edition of this Handbook was specifically issued for California).
- Additionally, the proposed rates do not comply with California's Constitution Article XIII, Section 6 (Proposition 218) which calls for the rate to each parcel (individual customer) to be based on its cost of service.
- If the SFID Board adopts the proposed rate structure contained in Carollo's November 2019 Draft Cost of Service Rate Study (study) this will result in inequitable rates for the SFR class of customers. (See AWWA Handbook page 150 Figure 9-1 and corresponding text for definitions of Cost-of-Service, Cost-of-Service Rates, and Equitable Rates. Further see also Handbook pages 157-159 for details on the three forms of rate equity).

The SFID's Board recent policy decision and rate design direction to its consultant to prepare a Five-Tier rate structure for SFR customers will result in a continuation of recent and current rate inequities into the near future. The following points elaborate on this Conclusion.

I. Equitable Rates for Each Class Must Precede Development of Rate Design

When different customer classes exist, such as is the case in this instance, industry guidelines (American Water Works Association Handbook pages 41, 158 (last paragraph and Graph 3-2); 159; AWWA M1 pgs. 4 Objectives; 5 Fig I 2.2; and page 6 Rate Design Analysis) for cost-of-service rates

require that cost allocations by class must precede the development of a rate design¹. This means that:

- All types of costs must be allocated by function (water supply, treatment, transmission, distribution, customer service, etc.) to derive the unit cost of that function. Appendix A
- Each class' cost share then is calculated by adding the applicable function's unit costs by the respective class consumption characteristics such as average, maximum day, maximum hour use and customer costs.
- This results in the determination of each User Class' Revenue Requirements.
- The rate design starts with UCRR by class. The unit consumption rate is the quotient of UCRR by class divided by the consumption volume of that class. If certain additional costs can be established as usage increases by tier, an additional cost can be added to the unit cost. Examples would be costs incurred for excessive or wasteful use.
- The Carollo rate structure errs by assigning selected low cost water supply to portions of the SFR class usage through an arbitrary system of rate blocks instead of after the determination of UCRR for the class. This is a basic case of overlooking the importance of meeting intraclass equity standards.
- Misapplying the 6 step rate methodology referred to above (AWWA Handbook p.159) causes substantial distortions from achieving an equitable rate structure and equitable SFR water rates.

II. What is Intra-Class Rate Equity

RSFA has submitted a number of presentations and written submittals to SFID that explained the three forms of rate equity that must be present to avoid subsidizations of some customers at the expense of other customers. The proposed rates do not meet intraclass rate equity criteria.

- Because the cost of water served to customers in the same class is constant the unit cost should be constant over the full range of reasonably used water. Proposition 218, as part of the California State Constitution, as well as the State Water Code amendments of 2009 (AB2882), clearly mean that rates must avoid charging large use customers of the same class more per unit of all needed use than smaller use customers.
- In the District's proposed multi-tier rate structure for single-family water customers, where

¹ Appendix A contains a number of pages from both the AWWA M1 and the AWWA Handbook that support the 6-step cost-of-service rate setting method needed to achieve equitable water rates. Also note that M1 warns not to disaggregate the user class peaking factors for assigning different factors among one class of customers.

the lowest water source cost is allocated to the first tier of water served to all individual customers, the water used in this tier is charged at a subsidized non-COS rate.

- Customers with water use solely within the first tier are subsidized by other users for all their water use.
- The unit cost rate should be charged regardless of any reasonable quantity (not excessive or wasted) used by each customer to meet the intraclass rate equity requirement. This is not the case in the proposed 5-tier rate structure.
- Further, any multi-tier rate structure where the water supply portion of the costs is disaggregated by the increasing costs of the respective water source, even though the actual water supplied to all customers is a uniform aggregated supply, is fundamentally flawed.
- When so implemented the proposed rates will result in a lower unit charge than actual cost-of-service for the lowest tier water charges compared with the higher use tier charges which will exceed the actual cost of water service provided and, therefore, fails to meet the intraclass rate equity standard. Thus, both Prop 218 and State Water Code requirements, as well as water industry COSS standards will have been violated.

III. Bi-Monthly Fixed Charge

To the extent that fixed capital charges for capacity are contained in a user's bill this might indicate that the intergenerational equity criterion is neglected.

Section 5.2.2 of the study report presents the recommendations for the fixed portion of the different customer classes bills. Some of these costs, such as the MEU calculation for Meters and Services should not be allocated based on a hydraulic equivalency of a customer's meter but on an equivalent meter and meter service costs index by size of meter.

III. Unit Cost of Service Does Not Change Within a Class.

Even though the recommended tier rates now include an "overlay" consumption allowance based on the size of the meter connection of an individual customer within in a given class, as described in section 5.3 it should be noted that the overlay is not based on a COS analysis but only by the size of the customer's meter. This is a very rough way to "give" larger meter customers a "discount" on their water use in higher tiers. Since larger meter customers have been charged larger System Development Charges when they installed a water meter, a more precise cost-based analysis should be performed to ensure these customers are not charged retroactively for the same capacity costs they already paid for.

IV. San Juan Capistrano Appellate Court Decision (à la Carollo)

The Carollo cost allocation methodology wrongly interprets the *Capistrano* decision. The following quotes are from the draft Carollo report page 4-2. In this trend setting opinion the California Court

of Appeal stated that any rates, including tiered rates, must “correspond to the actual cost of providing service at a given level of usage.” (emphasis added.) Furthermore, the court stated:

“And, we emphasize, there is nothing at all in [California Constitution Article XIII D, section 6,] subdivision (b)(3) or elsewhere in Proposition 218 that prevents water agencies from passing on the incrementally higher costs of expensive water to incrementally higher users. That would seem like a good idea. But subdivision (b)(3) does require they figure out the true cost of water, not simply draw lines based on water budgets... Our courts have made it clear they interpret the Constitution to allow tiered pricing; but the voters have made it clear they want it done in a particular way.”

The Carollo report then concludes:

“This statement from the court outlines several fundamental principles for this rate analysis:

- Rates must be based on the cost of providing water service.
- Tiered pricing is an acceptable methodology under Proposition 218.
- Increasing block rates that pass incrementally higher costs of expensive water onto incrementally higher demand users is an acceptable methodology of proportionately allocating the costs of service under Proposition 218.”

The Carollo report’s last conclusion is not consistent with the foremost principle of the *Capistrano* ruling – do not charge more than the actual cost to serve water. The Court’s ruling, however, can logically be applied to the establishment of System Development Charges for new water customers. The then current cost of existing and planned new capacity costs can be passed on to these customers. User charges, however, require actual current costs to be used using an average cost methodology to calculate unit costs by function. The actual cost of water service is the average cost of all water supplied in a given billing period. That is not the case in Carollo’s proposed methodology because it handpicks the cheapest water supply available to the District and reserves that for the lowest tier of water use.

Although one argument advanced by Carollo is that all users have an equal opportunity to get low-cost tier 1 water it is clear that this “opportunity rate” is not at a Cost-of-Service rate. The larger a customer’s need for and use of water is, the larger his/her overcharge will be as a percentage of its bill. This is a clear example of rate subsidization of smaller SFR customers.

Furthermore, this practice totally disregards the need to aggregate the cost of all water sources actually served at a given time to account for water service cost to each parcel or customer. When water is served to its customers that water consists of the commingled water sources

that are mixed at the treatment plant. Never will the cheapest water source be singled from the other water sources and served solely to any customer!

Lastly, the disaggregation of the water source supply costs in the proposed methodology has another perverse effect on rate equity. By setting aside the lowest supply cost- local rain or well water for SFR small users, all other users will have to carry the resulting increase in water supply cost in the calculation of their respective User Charge Revenue Requirements. This means that their respective class rate will increase proportionally to the increase in their USRR. This is a case of Interclass Rate Inequity.

V. CONCLUSION

The proposed user rates are the result of a social engineering or political decision to promote water conservation using the price elasticity of demand principle to lower consumption at higher price levels plus benefitting the smallest SFR users by charging them less than the actual cost of the commingled water provided to them.