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PLU – Recent Appellate Cases Exhort Public Agencies to Carefully Document the Proportionate Costs of Services Charged

Takeaway

Four recent decisions of California courts of appeals once again remind public agencies of the critical importance of adequately documenting the costs intended to be covered by a fee charged for a wide range of public services, including: (1) a fee for administrative services must be proportionate to the cost of providing the services to the fee payor (Riverside); (2) a fee for solid waste services may not include costs of maintaining public streets damaged by waste hauling vehicles (Redlands); (3) a regulatory fee must be based on costs of the individualized elements of Proposition 26 (San Jose); and (4) tiered water rates must be based on the cost at each tier of providing water service to customers (San Diego).

Analysis

Each of the four cases summarized in this article are centered on a common theme. It is critical for each local agency to prepare documentation (e.g., fee study, cost of service study, or nexus study) to support its burden of proof under Proposition 26 (California Constitution Article XIII C, Section 1(e)) that the amount of the fee does not exceed the reasonable cost of the agency activity funded, and that the agency's costs are allocated based on a reasonable relationship to the burden imposed or benefit received by each fee payor. If a fee does not satisfy the requirements of Proposition 26, the charge is considered an unlawful tax, and it is subject to potential refund to the fee payor, unless it receives the required approval from voters.

1. Fees for administrative services must be proportionate to the service provided to each payor.

In *Scott v. County of Riverside* (2025) 112 Cal.App.5th 265, the owners of timeshare estates challenged an annual fee intended to cover the County's administrative costs of evaluating and processing property taxes and assessments owed by owners. The County calculated the fee by dividing the total cost of operating the assessor's office (minus

grant funds) by the total number of parcels served, with each parcel charged the same fee. The owners argued the fee exceeded the reasonable cost of providing the administrative services in violation of Prop 26 (Article XIII C of the California Constitution) since the County's costs of serving timeshare estates was significantly less than the costs of serving other parcels charged the same fee, and since the cost of operating the assessor's office included costs for services not provided to the owner charged the fee. The Court held that, under Prop 26, a public agency may not charge a fee that (a) exceeds the proportionate reasonable cost of providing the service, or (b) is based on services that are also provided to those not charged the fee. Consequently, the case was remanded to the trial court to determine the overcharged portion of the fee to be refunded to the owners.

2. Fees for solid waste collection may not include costs of repairing streets.

In *Rogers v. City of Redland* (2025) 112 Cal.App.5th 667, a resident challenged a solid waste collection fee surcharge that was intended to cover the City's costs of maintaining streets that are degraded by wear from use by garbage trucks. The Court of Appeal held that the surcharge is subject to the limits of Vehicle Code Section 9400.8 which prohibits local agencies from imposing a charge for "the privilege of using" city streets. Thus, the court held that the use of City streets by the City's solid waste contractor was a "privilege" of using the streets for which the City could not charge the costs of maintenance to the contractor or to the customers served by the contractor. However, the court also concluded that refunds for such charges are limited to those who paid under protest, per Health and Safety Code section 5472.

3. Regulatory fees must be justified based on the individualized component costs identified in Proposition 26 "Exception 3."

In *Sutter's Place v. City of San Jose* (2024) 104 Cal.App.5th 855, a cardroom operator challenged the City's fee to cover the costs of regulating cardrooms based on allegations: (a) the City's costs were not tied to the specific requirements of Proposition 26, and (b) the fee was not proportionately allocated to fee payors (there were two cardrooms with allegedly different impacts on the City that were charged the same fee). The City's fee for cardroom regulations is based on the Prop 26 exception for regulatory fees (Cal. Const. Art. XIII C, sec, 1(e)(3)), referred to as "Exception 3"). To qualify for Exception 3, "[i]t is not enough to show that the charge reflects the government's reasonable regulatory costs; the government must also show that the costs are incurred in performing only permissible activities." Since Exception 3 "describes activities of an individual rather than programmatic nature," local agencies must "review specific activities and associated costs … to determine

whether they relate to [one of the following individual categories:] issuing licenses and permits; performing investigations, inspections, and audits[, enforcing agricultural marketing orders]; or the administrative enforcement and adjudication thereof." The Court of Appeal remanded this issue to the trial court to determine the extent to which the City had adequately documented its costs as being within Exception 3. However, the Court of Appeal held that substantial evidence supported a finding that the fee allocation between the two cardrooms was fair and reasonable. Additionally, the Court held that the plaintiff is entitled to a refund only on the portion of costs that exceed what is authorized under Exception 3.

4. Tiered water rates must be based on the proportionate cost of providing water at each tier.

In *Patz v. City of San Diego* (2025 WL 2158329), a residential property owner filed a class action challenge to a "tiered water rate" arguing that the City charged a disproportionate fee to customers in different tiers that were not based on the City's costs of providing the water at each tier. The City established four tiers based on the volume of water used by customers, with Tier 1 based on below average use, Tier 2 is average, Tier 3 is above average, and Tier 4 is "high use." For each tier, the City charged the lowest rate per "unit" of water to Tier 1, then each higher tier is charged a higher rate for each unit of water received. Thus, a customer using one gallon of Tier 2 water is charged a higher rate per gallon than a customer using one gallon of Tier 1 water, with additional increased rates with water received through tiers 3 and 4. The City argued the varying rates at different tiers are justified based on the varying costs of providing water based on "base" costs (for the water system needed to deliver "average day demands" of water), and "peaking factors" for "max day" (for the water system needed to deliver the greatest volume of water used in any single day), and "max hour" (for the water system needed to deliver the greatest volume of water used in any single hour). However, after a 116-page majority opinion and a 62-page vigorous dissent, the Court concluded there was no logical or proportionate connection between the City's costs of delivering water for max day or max hour, compared to the number of water units received by paying customers at each tier, that were not based on the time of delivery. Thus, the Court held the City did not document that the costs of water delivered for higher tiers of use were based on costs of delivering water during a particular max day or max hour. This *Patz* decision incorporates analysis of the line of cases that preceded it, scrutinizing tiered water rates as a property-related fee under Proposition 218, including *Coziar v. Otay Water Dist.* (2024) 103 Cal.App.5th 785.

Notably, the *Patz* court supported a trial court calculation of overpaid charges (based on disproportionate tiered rates) in the amount of $79,541,880; however, the court denied the plaintiff's request for a

refund, and remanded the case to the trial court to determine how the past overcharges will need to be credited by the City against future water rate updates. This is based on Government Code Section 53758.5 (effective January 1, 2025). (See our prior summary at https://www.bwslaw.com/news/public-law-update-legislation-provides-optional-process-for-updating-rates-for-water-and-sewer-services-and-for-any-assessments-to-limit-litigation/.)

Attorneys at Burke regularly advise clients on legal matters related to the establishment and implementation of fees in compliance with the requirements of Propositions 26 and 218, as well as the *Nollan/Dolan* Doctrine and the Mitigation Fee Act.

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