City of Long Beach
Working Together to Serve

Office of Gerrie Schipske
Councilwoman, Fifth District
Memorandum

R-17

Date: January 22, 2008

To: HONORABLE MAYOR AND MEMBERS OF THE CITY COUNCIL

From: Councilwoman Gerrie Schipske, Fifth District GS

Subject: AGENDA ITEM: **Impact of Potential Utility User Tax Litigation**

DISCUSSION

Recently, the League of California Cities held a conference on the impact of pending litigation filed by plaintiffs alleging that cities and counties are illegally assessing certain taxes on telephone services and fees on hotels. Verizon has taken the lead among them and has begun to litigate to reduce the utility taxes on their services.

I am attaching an overview prepared for this conference that outlines the potential impact if these litigants are successful.

Should those parties attempting to reduce such fees succeed, a loss of these funds would deal a serious blow to the City of Long Beach. The City of Los Angeles has already taken steps to protect itself should the decision regarding its imposition of a utility user tax on telephone services be invalidated by the court. The City of Long Beach also should be prepared and ensure that we are in proper legal standing with regards to the challenges to these taxes and fees.

RECOMMENDATION

Request the City Manager and the City Attorney to provide a briefing to the City Council within thirty days regarding the impact of pending litigation challenging telephone taxes and fees currently imposed by the City of Long Beach and steps to be taken should the Courts rule that such taxes and fees are illegal and a violation of Proposition 218.

Attachment: ***CURRENT DEVELOPMENTS UNDER PROPOSITION 218 Bighorn, Utility Fees, and More***

Michael G. Colantuono
MColantuono@CLLAW.US
(530) 432-7359

Colantuono & Levin, PC
11406 Pleasant Valley Road
Penn Valley, CA 95946-9024
Main: (530) 432-7357
FAX: (530) 432-7356
WWW.CLLAW.US

League of California Cities
Financial Management Seminar
Monterey, California
December 6, 2007

CURRENT DEVELOPMENTS UNDER PROPOSITION 218
Bighorn, Utility Fees, and More

1. Utility Users Tax Litigation

Most utility users taxes ordinances in California date from a model ordinance developed by the League of California Cities in the mid-1980s after negotiations with the major utilities. Since that time, the telecommunications industry has been completely transformed with the break up of Ma Bell, the demise of telegrams, and the internet revolution. Now that Propositions 62 and 218 require voter approval of any change in the "methodology" by which a tax is administered (Government Code § 53750(h)), the telephone carriers – Verizon lead among them – have begun to litigate to reduce the utility taxes on their services.

Federal Excise Tax Challenges to UUTs on Telephony. Several federal courts have concluded that telephone service packages which provide a mix of local and long-distance calling for a flat rate per minute or a fixed fee for unlimited dialing are neither "local" nor "long distance" telephone calls taxable under the Federal Excise Tax on Telephones (FET), 42 U.S.C. 4251 et seq. The FET taxes three categories of calls based on AT&T's 1967 billing structure – local calls, a category which assumes a fixed monthly fee for unlimited dialing in a defined geographical area; long-distance calls billed on the basis of both the duration of the call and the distance between the two telephones served; and Wide Area Telephone Service or WATS service, which provided unlimited or large volumes of calls to and from a defined geographic area for a fixed monthly fee. The League of California Cities' model ordinance exempts from the local utility tax telephone calls – such as those paid by coin in phone booths – which are exempt from the FET. Thus, because calls which are not charged based on both time and distance are not taxable under the FET, carriers and their customers argue that they are not taxable under local UUT ordinances which reference the FET.

The IRS issued its Notice 2006-50, effective July 1, 2006, which acquiesced in these federal court rulings, and determined that the FET does not apply to long distance calls which are

not billed on *both* the bases of time and distance (distance is frequently excluded from nationwide "one-rate" plans). However, the IRS notice went further, and narrowed the FET to separately billed local services, and eliminated the tax on bundled charges for both taxable and non-taxable calls, despite express language in the FET and in the Mobile Telecommunications Sourcing Act of 2000, 4 U.S.C. §§ 116 et seq. (MTSA) that the FET applies to bundled charges and that state and local telephone taxes on cellular telephony may be applied to bundled charges.

In response to the concerns raised by local governments about the impact of Notice 2006-50, the IRS issued its Revenue Bulletin 2007-5 on January 29, 2007 clarifying Notice 2006-50 and stating in Section 10: "Neither Notice 2006-50 nor this notice affect the ability of state or local governments to impose or collect telecommunication taxes under the respective statutes of those governments."

Although litigation in Santa Clara Superior Court testing the import of the federal FET rulings for Palo Alto's UUT has settled, several suits raising these same issues have been filed in Los Angeles Superior Court and a case has been filed in Sacramento as well. The same plaintiffs' counsel are involved in all the LA Superior cases, and we assume the defendants were chosen due to their very large shares of California's telecommunications market.

Class Action Litigation Against the City of Los Angeles, the City of Long Beach and the County of Los Angeles: Three class action lawsuits were filed against the City of Los Angeles, the City of Long Beach and the County of Los Angeles in Los Angeles County Superior Court: *Estuarado Ardon et al. v. City of Los Angeles*; *John McWilliams et al. v. City of Long Beach*, and *Willy Granados et al. v. County of Los Angeles*. The complaints in these cases all involve the same theories.

All three defendants demurred, arguing that a line of cases led by *Woosley v. State of California*, 3 Cal.4th 758 (1992), prohibits a class action for tax refunds in the absence of explicit legislative authorization. The trial court granted Long Beach's and Los Angeles County's demurrers, with leave to amend, holding that the class plaintiffs had failed to exhaust their administrative remedies by filing a claim under local claiming ordinances. These cases are now pending on appeal. Los Angeles also won its demurrer in the *Ardon* case and the plaintiffs there appealed the dismissal of their class claims (in an interlocutory appeal under the "death-knell doctrine") while maintaining their trial court litigation on individual refund claims of the named plaintiffs and a claim for declaratory relief. That case is now in discovery.

TracFone Litigation: TracFone Wireless, Inc. filed lawsuits against the City and County of Los Angeles raising the FET challenge to these agencies' UUTs on telephony. TracFone sells prepaid telephone calling cards that provide service via wireless handsets TracFone also sells. TracFone alleges that it typically sells its calling cards to retailers, who in turn resell the cards to consumers. Rather than collect the tax from the consumer, TracFone chose to pay the tax out of its own funds. Both the City of Los Angeles and the County of Los Angeles filed demurrers,

arguing that TracFone acted as a volunteer and lacks standing to sue for a tax refund. The trial court granted the County's demurrer, holding that TracFone lacked standing to seek a refund of a tax that it was not obliged to pay, but only to collect. The City of Los Angeles got a different result, with the trial court concluding that TracFone has properly alleged a declaratory relief claim and that action continues, but this case may be stayed pending resolution of the appeals in the other cases.

The Sacramento case is *Howard Jarvis Taxpayers Ass'n, et al. v. City of Sacramento*, Sacramento Superior Court Case No. 07 CS 00810. It was filed in June 2007 and, as this paper has written, remains at the pleading stage. The case seeks to invalidate the application of Sacramento's UUT to calls outside the base of the FET and seeks declaratory relief and a writ compelling the County Auditor to reduce Sacramento's property tax proceeds by the amount it receives from the allegedly illicit overbreadth of the UUT. That remedy is provided for by Proposition 62, which several courts have ruled inapplicable to charter cities such as Sacramento. As the LA cases are already pending in the Second District Court of Appeal, we may have appellate guidance on these issues before the Sacramento case is resolved.

Plainly, the 100+ cities and 4 counties in California with UUTs on telephony should review their taxes in light of these developments. The most important first step is to ensure that the agency has a good claiming ordinance pursuant to Government Code §§ 905(a) and 935 to require a claim for tax refund cases and to bar class and representative claims.[1] A model of such an ordinance is available at www.cllaw.us/papers.htm. Further important steps are to determine whether and how to amend a UUT ordinance to eliminate references to the FET and to consider whether to present the amending ordinance to the voters. These decisions should be made in consultation with legal counsel, as there are significant issues regarding both the FET and Proposition 218 to be considered.

Proposition 218 Challenges to UUTs on Telephony: AB Cellular LA, LLC dba AT&T Wireless v. City of Los Angeles, 150 Cal.App.4th 747 (2007) involves Los Angeles' effort to apply its UUT to the call-detail portion of cellular telephone bills. Prior to the adoption of the Mobile Telecommunications Sourcing Act of 2000 (MTSA) by Congress, cellular carriers argued that the federal Constitution forbade the application of a UUT to telephone calls which neither originated nor destinated in the taxing city. Because the wireless carriers had not developed technology to track the origin and destination of calls, Los Angeles allowed them to tax the monthly base rate for cell service, and not to tax individual calls. After the 2002 effective date of the MTSA, Los Angeles sought to enforce its tax on all cell calls within its jurisdiction (which, under the MTSA, includes all calls billed to an account with a Los Angeles address). Verizon sued to invalidate the City's directive, arguing that Los Angeles had "changed its methodology" for administering the tax and could not do so without a vote of the electorate

[1] A recent decision dismissing a class action on the basis of such an ordinance is discussed in section 5 of this paper below.

under Prop. 218. In light of this trend of cases, agencies which rely on UUTs on telephony should look for an opportunity to seek voter approval of an updated ordinance that reflects the realities of the modern telecommunications industry.

In *AB Cellular*, the Second District Court of Appeal affirmed a trial court ruling that Los Angeles could not direct cellphone carriers to tax all calls billed to an address in the City without voter approval. However, the Court allowed the City to reimpose a 1993 instruction to carriers requiring them to tax all calls which originate or terminate in the City even though Los Angeles had acquiesced in carriers' refusal to do so while the technology to track calls was developed. The result is that Los Angeles preserved the great majority of the tax base in dispute in this case and local governments throughout California have greater clarity as to what administrative actions regarding a tax will be construed as a tax "increase" for which Proposition 218 requires voter approval. Los Angeles may have lost the case, but it won most of what was really in issue.

The analysis of the case provides useful guidance to local governments about how to administer a tax in a manner which will not trigger a duty to seek voter approval for a "change of methodology" which amounts to a tax increase.

2. Business License Taxes

In *Macy's Department Stores, Inc. v. City and County of San Francisco*, 143 Cal.App.4th 1444 (2006) (*review denied*), Macy's successfully challenged San Francisco's business license scheme, which required businesses to calculate taxes based on in-City payroll and gross receipts and to pay the larger of the two amounts. This approach was found to violate the internal consistency test of the Dormant Commerce Clause of the U.S. Constitution by favoring in-City businesses over businesses located elsewhere. The trial court granted Macy's a refund of *all* the taxes it had paid during the years in issue and awarded prejudgment interest of 7%. San Francisco appealed, arguing (i) the claims were untimely as to two of the years in issue under the City's local claiming ordinance, (ii) the refund should have been limited to the difference between the amount Macy's paid and the amount it would have paid under a non-discriminatory regime, and (iii) interest should have been calculated under a City ordinance that provided a lower rate than the 7% provided by state law.

The Court of Appeal agreed with the City only on the second issue, but even that saved the City millions of dollars. The timeliness issue turned on the language of specific San Francisco ordinances. The other two points are of broader application. Two lessons can be drawn from the case: First, every taxing agency should have an ordinance adopted pursuant to Government Code § 935, limiting refund claims to those filed within one year of the payment of the disputed tax and barring class-action and other representative claims. A model of such an ordinance is available at www.cllaw.us/papers.htm and was successfully litigated by the City of Roseville and a similar ordinance was successfully defended by San Francisco in the case discussed in section 5 of this paper, below. Second, taxing agencies with complex business tax

systems that provide multiple measures of the tax, incentives to locate in the agency's boundaries or in a specific area of the agency, or provide incentives to some businesses but not others, should consult with legal counsel to ensure their tax regimes can survive review under the very demanding tests now applied under the Dormant Commerce Clause.[2]

3. Special Taxes

Assemblyman Jared Huffman (D-San Rafael) introduced ACA 8 to amend Propositions 13 and 218 to allow special taxes and property-tax-over-ride bonds to be approved by 55% of a city or county's voters, instead of the presently required 2/3, if the voters of the jurisdiction approve an ordinance authorizing that vote threshold. The authorizing ordinance requires 2/3-voter approval. The measure never got a hearing and was later gutted and amended to serve as a vehicle for a League of California Cities proposal regarding eminent domain reform. Clearly the current legislative climate is not conducive to measures which will create additional authority for local governments to raise revenues.

4. Fees on Telephone Customers to Fund 911 Response and Related Services

San Francisco imposed a non-voter-approved fee on telephone bills to recover the cost of a significant and costly upgrade to its 911 response system following the Loma Prieta earthquake in 1989. More recently other local governments have implemented similar fees and litigation ensued in the general law City of Union City, the charter city of Stockton, and against the County of Santa Cruz. The central legal issues are whether such a fee is in fact a special tax or property-related fee for which voter or property-owner approval is required and whether the state 911 fee is preemptive as to some or all local governments.

Mancini v. County of Santa Cruz, 6th District Case No. H028434, is an unpublished victory for Santa Cruz County upholding its fee. Taxpayers' rights organizations successfully opposed publication of the decision.

Telephone carriers challenged Union City's 911 fee and obtained summary judgment in January 2006 on the grounds that the fee was a special tax for which voter approval is required. Union City has appealed and the case will soon be set for oral argument before the First District Court of Appeal in San Francisco. The case is captioned *City of Union City v. Bay Area Cellular Telephone*, 1st DCA Case No. A114956 and should be decided in early 2008.

The Third District Court of Appeal decided a procedural dispute in *Andal v. City of Stockton*, 137 Cal.App.4th 86 (2006), reversing the trial court's decision granting the City's demurrer on the ground that the Verizon and individual plaintiffs had not exhausted

[2] An *amicus* brief for the League of California Cities on behalf of San Francisco was written by my colleagues Sandi Levin, Holly Whatley, and Amy Sparrow.

administrative remedies before suing for declaratory relief. The Court concluded that administrative procedures need not be exhausted where effective relief cannot be granted – *i.e.*, where the remedy sought is declaratory relief that a fee is unconstitutional.

The underlying cases were resolved when the trial court granted the carriers' motion for summary judgment, concluding the fee was in fact a tax because "fee-payers receive nothing over and above that received by everyone else." Stockton appealed to the Third District Court of Appeal in August 2007 and the case is now being briefed.

I expect continued litigation in this area until the phone industry accomplishes its goal of a published, appellate precedent that 911 fees are special taxes requiring voter approval.

5. Hotel Bed Taxes

Kumar v. Superior Court (City of Cloverdale), 149 Cal.App.4th 543 (2007) is the latest, published appellate loss for attorney Frank Weiser's crusade against hotel bed taxes. The Court of Appeal upheld Cloverdale's ordinance against Weiser's claim that its definition of "hotel" was unconstitutionally vague like that of the ordinance struck down in *City of San Bernardino Hotel / Motel Ass'n v. City of San Bernardino*, 59 Cal.App.4th 237 (1997). Instead, the court found the ordinance more analogous to the ordinances upheld in *Patel v. Gilroy*, 97 Cal.App.4th 483, 489 (2002) and *City of Vacaville v. Pitamber*, 124 Cal.App.4th 739 (2004). Weiser also argued the ordinances violated equal protection by taxing persons based on the kind of housing they occupy and thereby taxed those too poor to afford longer-term occupancies. The Court rejected the claim, finding that taxable occupancies under the ordinance were those which did not exceed 29 days and that this classification withstood constitutional scrutiny. The Court also rejected a barely colorable argument that the ordinance was preempted by Revenue & Taxation Code § 7280(a), which authorizes ordinances of this very type.

Batt v. City and County of San Francisco, 155 Cal.App.4th 65 (2007), was a class action challenging application of the City's hotel bed tax to the portion of a hotel bill for parking a car, claiming it exceeded the tax authorized by the City's ordinance. The trial court sustained the City's demurrer to the class claim, citing the claiming requirement of the City's bed tax ordinance which expressly prohibited class claims. The Court of Appeal affirmed the ruling for the City, citing *Woosley v. State of California*, 3 Cal.4th 758 (1992), for the proposition that class actions challenging public revenue measures require express statutory authority and the San Francisco claiming ordinance expressly disclaimed any such authority. The case is helpful published appellate authority for the claiming ordinances long relied upon by local governments in public finance cases. Plaintiffs in such cases routinely cite *City of San Jose v. Superior Court,* 12 Cal.3d 447 (1974), which allowed a class claim against airport noise at San Jose's airport. The *Batt* court roundly rejected application of that case in the fiscal setting, citing the Supreme Court's decision in *Woosley* as its basis to do so:

> "The issue in *Woosley* was whether *City of San Jose* and its progeny would be extended to the class claims in issue there. The answer was a resounding 'No.' Writing for a unanimous court, Justice George disapproved all the cases expansively applying City of San Jose, and point blank held that 'City of San Jose ... should not be extended to include [class] claims for tax refunds.'"

The case is an important reaffirmation of these principles and a big win for local government.

Collection of Bed Taxes on Hotel Rooms Sold By Internet Resellers. A class action on behalf of local governments is now pending against a number of internet resellers of hotel rooms. Separate cases have been consolidated for trial in Los Angeles Superior Court. Those companies purchase rooms from hotels at a discounted rate, resell them at a higher rate, and are subject to local bed taxes as sellers of hotel occupancies. Rather than collecting the tax and remitting it to local governments, however, the companies rely on the hotel to pay the tax on the wholesale cost of the room, often keeping the tax on the spread between the wholesale and retail rates as a "fee" for the internet seller. Los Angeles, San Diego, West Hollywood and other cities filed class actions in Los Angeles and San Diego Superior Courts to challenge this practice and to recoup the underpaid taxes.

The Los Angeles trial court hearing the consolidated cases accepted the resellers' arguments that the local governments were required to exhaust their administrative remedies by auditing the resellers and providing a hearing to the resellers on the amount of taxes demanded. The court retained jurisdiction over the dispute and may well grant relief after the administrative proceedings are complete.

Agencies with substantial hotel occupancy receipts would do well to follow this litigation and to consider participating in it. The cases are *City of Los Angeles, et al. v. Hotels.com, L.P. et al.*, Los Angeles County Superior Court Case No. BC 326693, *City of San Diego v. Hotels.com, L.P. et al.*, San Diego County Superior Court Case No. GIC 861117, and the consolidated case number is JCCP 4472. Counsel for the local governments can provide more information about the case and the terms under which his firm will represent additional local governments: Paul Kiesel, Kiesel, Boucher & Larson, LLP, (310) 854-4444. More information about the case is posted to that firm's website at www.kbla.com.

6. Documentary Transfer Taxes

The Attorney General recently provided a formal opinion on procedural issues regarding the application of the documentary transfer tax. This tax is collected by county recorders when documents are recorded to effectuate the sale of an interest in real property and is shared between the county and the city in which the real property is located (or entirely retained by the county if the site is unincorporated). In *Opinion No. 06-1009,* 2007 WL 2076573 (2007), the Attorney

General concluded that a county recorder need not issue a separate document evidencing the tax, but must make tax records available for public inspection. This opinion will be important to those active in real estate, as the transfer tax is a percentage of the sales price of property and this allows third parties to discover what the sales price of a property.

7. Revenue Resources

The League of California Cities has recently produced a helpful analysis of the techniques available to a local government to persuade voters or property owners to approve a new revenue measure: *Voting Analysis – Local Revenue Enhance Measures – San Luis Obispo County – November 2006*, by Robb Korinke, available from the League of California Cities at (916) 658-8200.

Also of interest is a *Revenue Diversification Pamphlet* prepared by the Institute for Local Government, the non-profit research and education arm of the League of California Cities. That is available at www.ca-ilg.org/revenuediversification.

8. Utility Rates and the Bighorn Decision

The largest open question with respect to Prop. 218's impact on fees had long been whether ordinary rates for measured consumption of utility services, such as water and sewer charges, are subject to the majority protest proceeding required by Article XIII D, § 6(a) and the substantive rules regarding the use of fee proceeds (such as a ban on general fund transfers) of § 6(b). These questions were resolved by *Bighorn-Desert View Water Agency v. Verjil*, 39 Cal.4th 205 (2006).

The Court concluded that metered rates for consumption of water are "property related fees" subject to the measure. The ruling also applies to sewer service charges and charges for refuse collection by a government agency, rather than by a private waste hauler.

Article 13D of the California Constitution created a category of fees known as "property related fees." Such fees may not be imposed or increased unless a local government conducts a majority-protest proceeding 45 days after mailing notice to all fee payers. Art. 13D, § 6(a). If no majority protest occurs (as is likely, given how difficult it will be to get a majority of property owners to participate in all but the smallest districts), then the agency must submit the measure to a mailed-ballot, majority vote of property owners (voting one vote per parcel) or to an at-the-polls, ⅔-vote of registered voters. Art. 13D, § 6(c). This second requirement does not apply to fees for water, sanitary sewer, and trash services. *Id.*

In 2001, the Supreme Court held in *Apartment Ass'n v. City of Los Angeles,* 24 Cal.4th 830, that a fee is not "property related" and subject to Proposition 218 if it can be avoided by means other than selling the property – such as not engaging in residential leasing or not taking

water. The Los Angeles Court of Appeal reached the same conclusion as to metered water rates in *Howard Jarvis Taxpayers Ass'n v. Los Angeles*, 85 Cal.App.4th 79 (2000).

In 2004, the Supreme Court's decision in *Richmond v. Shasta Community Services District*, 32 Cal.4th 409, held Proposition 218 inapplicable to water connection charges on new development because these charges result not from property ownership, but from voluntary decisions to develop property. That decision, however, suggested that charges for continuing service to an existing water meter might be subject to Proposition 218.

Bighorn involved an initiative to reduce the Bighorn district's water rates by half and to require ⅔-voter approval for future rate increases. When the Interim San Bernardino County Registrar of Voters certified that the proponents had obtained sufficient valid signatures to require an election on the measure, the District sued to remove the matter from the ballot on the ground that it exceeded the initiative power created by Article 13C of Proposition 218 by affecting a fee which is not subject to the proposition, impairing essential governmental fiscal powers, and exercising powers the Legislature delegated to the District's Board alone. The trial court ruled for the District and the Riverside panel of the Court of Appeal affirmed. However, the Supreme Court granted review and returned the case to the appellate court for reconsideration in light of *Richmond*. The Court of Appeal renewed its decision and the Supreme Court granted review of the case a second time.

The Supreme Court's decision in *Bighorn* definitively rejects an argument made by public lawyers since the 1996 adoption of Proposition 218 that its property-related-fee provisions do not apply to fees based on measured consumption of utility service. That argument reasoned that whether and how much utility service to consume is a voluntary decision and not merely an aspect of property ownership. Writing for a unanimous court, Justice Kennard wrote:

> "[D]omestic water delivery through a pipeline is a property-related service within the meaning of this definition [of property related fee]. Accordingly, once a property owner or resident has paid the connection charges and has become a customer of a public water agency, all charges for water delivery incurred thereafter are charges for property related services, whether the charge is calculated on the basis of consumption or is imposed as a fixed monthly fee." *Id.*, 29 Cal.4th at 217 (citations omitted).

The key phrase here is "for water delivery," so turn-on, turn-off, meter-repair and other charges for services other than ongoing water service itself are not made subject to Proposition 218 by this decision.

As to public agency charges for water, sewer and government-provided trash service, this means local governments must comply with the notice and majority protest proceedings of Article 13D, § 6(a), but not the election requirement of § 6(c), because a partial exemption

applies to charges for these services. In addition, revenues from service charges for water, sewer and government-provided trash service are governed by the rules of § 6(b). These generally require that rates not exceed the cost of providing the service and that rate proceeds be used only to provide the service.

Bighorn raises substantial questions about who should receive notice of a proposed utility rate increase and who is entitled to a protest. Common sense and the text of Proposition 218 would seem to dictate that these two groups ought to be the same. As to fees collected on the property tax roll, there is little doubt that notices are due to record owners of property listed on the latest equalized assessment roll. Article XIII D, 6(a)(1); Government Code § 53750(j). As to fees collected via a utility bill, however, a question arises whether notices should be given to record owners of property, utility customers (who receive utility bills), or both. Prop. 218 defines "property ownership" to include tenancies where the tenant is "directly liable" to pay the fee in question, as would seem to be the case where a tenant, rather than a property owner, is the customer who receives and pays utility bills. Article XIII D, 2(g). In addition, the Prop. 218 Omnibus Implementation Act allows notice to be given via an insert in a utility bill which, obviously, is addressed to utility customers rather than property owners. Government Code § 53750(i). A.B. 1260 (Caballero, D-Watsonville), effective January 1, 2008, resolves these issues and is discussed in section 9 of this paper below.

For more discussion of utility rates post-*Bighorn*, see section 13 of this paper below.

9. Post-*Bighorn* Legislation

Assemblywoman Anna Caballero (D-Salinas), chair of the Assembly Local Government Committee and a former Mayor and Councilmember of Salinas, introduced A.B. 1260 to clarify how the Prop. 218 protest proceedings are to apply to utility fees and other property related fees and charges. Sponsored by the Association of California Water Agencies, the measure adopts Government Code § 53755, a provision of the Proposition 218 Omnibus Implementation Act, to: (i) authorize notice of an increase in a fee collected via utility bills to be mailed to the address to which bills are mailed and allow a notice to be included with a bill, (ii) authorize notice of a new fee to be mailed to a utility billing address if the agency provides another property-related service to that address; (iii) require notice to property owners at the address shown on the assessor's roll if the agency "desires to preserve any authority it may have to record or enforce a lien on the parcel to which service is provided;" (iv) provide that only one protest need be counted per parcel; and, (v) allow an agency which provides billing services for another agency to provide notice of that other agency's fee adoptions and increases.

Governor Schwarzenegger signed the bill into law and, effective January 1, 2008, the question of who gets notice of a property-related fee can be summarized this way: notice can be given to the billing address (and not to the address of the owner on the assessor's roll) and included in a bill if it is for a fee increase or a new fee to an existing utility customer; notice must

be given to a property owner at the address on the assessor's roll only if the agency wishes to lien the property to collect delinquencies. The one-protest-per-parcel rule which many agencies have adopted by resolutions implementing Proposition 218 will soon be a state statutory rule.

10. Other Utility Fee Developments

Another development of interest to water providers is A.B. 2951 (Goldberg, D-Los Angeles), which Governor Schwarzenegger signed into law in fall 2006. That bill adopted Government Code §§ 54999.1, 54999.7 and 54999.8 to respond to the decision in *San Marcos Water Dist. v. San Marcos Unified School Dist.*, 190 Cal.App.3d 1083 (1987), which forbade public utilities to charge schools and other local government customers the portion of a utility rate which reflects capital costs. As utilities generally cannot charge one customer for costs attributed to another, this left local utilities with a duty to subsidize service to schools and other local governments and no means to raise funds to do so. A.B. 2951 clarifies that local government customers of public water and sewer utilities can be charged a non-discriminatory capital facilities rate component or capital facilities fee.

Agencies with an interest in these issues should also review *City of Marina v. Bd. of Trustees of the California State University*, 39 Cal.App.4th 341 (2006). In that case, the 6th District Court of Appeal held that *San Marcos* did not bar CSU Monterey Bay from agreeing to mitigate the impacts on the infrastructure of the Fort Ord Reuse Authority arising from expansion of the CSU campus there. Thus, some 19 years after the *San Marcos* decision most utility lawyers viewed as flatly wrong, much of the damage has finally been undone.

Also of interest is S.B. 699 (Ducheny, D-San Diego), which Governor Schwarzenegger signed into law in July as Chapter 699 of the Statutes of 2007. This bill amends the Mitigation Fee Act (Gov't Code § 66013(c)) to make clear that development impact fees can be imposed to acquire water rights and otherwise to expand services to serve new development. The statute was sponsored by the Coachella Valley Water District in response to an unpublished decision of the 6th District Court of Appeal in San Jose invalidating a development impact fee imposed by the Pajaro Valley Water Management Agency on the ground that the statute authorized fees to fund capital facilities, but not services per se. Given the new requirements under CEQA and water-planning statutes that developers identify assured water supplies to serve their developments, this measure was supported by local governments and the building industry.

11. General Fund Transfers

Under the *Bighorn* case discussed in section 8 of this paper above, transfers from utility accounts into an agency's general fund now must be justified as repayment of a loan to the utility by the general fund or as reimbursement to the general fund of the cost of services provided to the utility. *Howard Jarvis Taxpayers Ass'n v. Roseville*, 97 Cal.App.4th 637 (2002), and *Howard Jarvis Taxpayers Ass'n v. Fresno,* 127 Cal.App.4th 914 (2005), suggest such charges might

include the cost of police and fire protection of utility property and the wear and tear on public streets attributable to utility operations. Alternatively, such transfers can be approved by voters as general or special taxes. Cost allocation plans and repayments with utility funds of loans from the general fund, however, raise no issues under Props. 13 and 218.

In 1986, the California Supreme Court held that Ventura was entitled to a "reasonable rate of return" on water rates charged to non-City residents, suggesting a return on investment might be earned by any public utility. *Hansen v. City of San Buenaventura*, 42 Cal.3d 1172 (1986). In light of *Bighorn* and *Roseville*, however, *Hansen* would appear to be limited to enterprise funds not subject to Prop. 218, such as gas and electric utilities (these services are exempt from Prop. 218 under Article XIII D, § 3(b)) and enterprise funds which operate golf courses, community centers, and other non-utility services.

Moreover, both the *Fresno* and *Roseville* cases acknowledge that utility funds can be used to reimburse the general fund for services or for impacts of utility services on public safety services and streets. Nor is there any reason that the voters of a city could not approve a transfer of utility funds as a general or special tax, such as a utility user's tax.

Los Angeles' Department of Water and Power has paid a substantial amount to the City's general fund in recent years. After *Bighorn*, the City filed a validation action seeking a court judgment the practice is lawful. The Howard Jarvis Taxpayers Association answered the complaint, which is now pending in the Los Angeles County Superior Court.

12. Storm Water Funding

Given the post-Katrina attention to the serious flood hazards in the Central Valley and Delta and the increasing cost of mandates under the federal Clean Water Act, such as the National Pollutant Discharge Elimination System (NPDES) and Total Maximum Daily Load (TMDL) regulations on effluent from municipal storm water systems, local governments are increasingly looking for means to fund water-quality and storm-water-control programs.

Voter-approved general and special taxes are clearly legal means to fund these services. Los Angeles County imposed such a tax at the November 2005 election. Assessments are defensible, too, if special benefit can be shown, as will almost always be true for flood control programs, but which may be more difficult to show for water-quality programs.

Imposing a property-related fee in compliance with Prop. 218's mailed ballot vote of property owners or 2/3-voter approval is lawful under Article XIII D, § 6(c). Palo Alto failed in such an effort several years ago, and succeeded on a second try in April 2005. Rancho Palos Verdes adopted such a fee by a very narrow margin and opponents obtained sufficient signatures under the very low standard of Proposition 218's Article XIII C, § 3 to place the matter on the November 2007 ballot for possible repeal; the measure was rejected, although a companion

measure placed on the ballot by the City revising the fee was approved. The coastal community of San Clemente also succeeded in adopting a property related fee for water-quality programs. Encinitas' Clean Water Regulatory Fee adopted in 2005 without voter approval drew challenge by the Howard Jarvis Taxpayers Association and the City settled the case by agreeing to seek voter approval. Solana Beach litigated a similar fee and Del Mar faced a threat of suit from HJTA on its fee, as well. Dixon's effort to increase sewer rate hikes to fund improvements to its treatment systems mandated by the Regional Water Quality Control Board was rescinded via initiative in November 2006.

Non-property related regulatory fees (*e.g.*, inspection and permitting fees) are also lawful and do not require voter approval, but must be limited to the cost of the regulatory program for which they are imposed. Further discussion of this issue is included in sections 13 and 14 of this paper, below.

Utility fund transfers are lawful under the *Roseville* and *Fresno* cases to the extent it can be shown that utility operations impose costs on storm water program and the transfers do not exceed those costs.

Efforts to establish substantial revenue streams sufficient for the large capital costs associated with these federal mandates have been less successful. An early effort to characterize storm water programs as "sewer" services exempt from the election requirement of Article XIII D, § 6(c) was rebuffed in *Howard Jarvis Taxpayers Ass'n v. City of Salinas*, 98 Cal.App.4th 1351 (2002). That Court concluded that a fee on the property tax roll based on the amount of impervious coverage maintained on a parcel was a property-related fee subject to Prop. 218 fee even though property owners could avoid the fee by detaining or treating storm water on-site. The Court also concluded, without substantial analysis, that the partial exemption in Article XIII, § 6(a) for "water, sewer, and trash" fees included sanitary, but not storm, sewers.

The only successful legislation in recent years on this topic was 2003's AB 1546 (Simitian, D-Palo Alto) which authorized the City/County Association of Governments of San Mateo County to impose an annual $4 fee on motor vehicle registrations to fund traffic congestion and programs to mitigate stormwater pollution from roadways in the County. *See* Government Code §§ 65089.11 et seq. A 2004 effort to extend this to the 9-county Bay Area, A.B. 204 (Nation, D-Marin), died in the Senate. Governor Schwarzenegger vetoed A.B. 1003 (Nava, D-Santa Barbara), which would have authorized the Ventura County Watershed Protection District to impose a property-related fee for water quality programs. The Governor's veto statement cited Prop. 218 and reads as though written by the Howard Jarvis Taxpayers Association.

Senator Tom Harman (R-Huntington Beach) twice introduced an Assembly Constitutional Amendment to add storm sewers to Article XIII D, § 6(a)'s partial exemption for water, sewer, and trash fees. If his measure had been successful, such fees would have become

subject to a majority protest, but not a property-owner mailed-ballot or 2/3-voter election. ACA 10 in the 2003-04 Legislature never got a hearing and ACA 13 met the same fate in the 2005-06 Legislature. Neither proposal got the support of a single Republican in the Legislature other than the author. Moreover, conservative activists in Orange County tried (unsuccessfully) to prevent Mr. Harman from winning a vacant Senate seat in the June 2006 Primary, but did prevent his wife, Diane, from winning the Republican nomination to succeed him in the Assembly.

A more narrowly tailored proposal was ACA 30 (Laird, D-Santa Cruz), which would have amended the assessment provisions of Article XIII D, § 4 to allow an assessment to be imposed or increased "to maintain, operate, repair, relocate, or upgrade a flood control levee, which levee was in existence before November 6, 1996 [*i.e.*, the effective date of Prop. 218]" pursuant to a pre-Prop. 218 majority protect proceeding, rather than a Prop. 218-style mailed-ballot election among property owners. The measure died on the Assembly floor in August 2006.

Senators Torlakson (D-Antioch) and Yee (D-San Francisco) have tried again in the current legislative session with SCA 12, which would amend Article XIII D, § 6(c) to add "urban runoff management" to the list of services for which property-related fees do not require voter- or property-owner-approval. The matter did not make it to the Senate floor in the 2007 session and is a two-year measure. Two-thirds approval on the Senate floor may be unlikely. Notably, Senator Harman voted against the measure in committee, stating that he had changed his opinion on the proposal since his sponsorship of ACA 10 and ACA 13 due to his support for Proposition 218. He has thus returned to the current Republican orthodoxy on these issues.

County of Los Angeles v. Commission on State Mandates (Los Angeles Regional Water Quality Control Board), 150 Cal.App.4th 898 (2007) concluded that the mandate reimbursement provision of Proposition 13, Article XIII B, § 6 required the Commission on State Mandates to consider a test claim against the Regional Water Quality Control Board seeking reimbursement of the cost of complying with NPDES requirements. The RWQCB had claimed exemption from the mandates process under a provision of the Government Code governing the Board's operation. The Court found that the constitution prohibits the Legislature from exempting RWQCB rules from the mandate process and remanded the matter to the Mandates Commission for review. This is one aspect of a multifarious legal battle underway over the NPDES requirements.

13. Regulatory Fees

Generally a local government's power to impose a fee to support a regulatory program is as broad as its police power to regulate. *E.g., Sinclair Paint v. State Board of Equalization*, 15 Cal.4th 866 (1997). However, there are limits on this power, as exemplified by *County Sanitation Dist. No. 2 of Los Angeles County v. County of Kern*, 127 Cal.App.4th 1544 (2005), in which the Fifth District Court of Appeal in Fresno invalidated a regulatory fee that Kern County

imposed on those who import sewage sludge into the County on the basis of the use of public roads. The Court cited Vehicle Code § 9400.8, which reads in relevant part:

> "Notwithstanding any other provision of law, ... no local agency may impose a tax, permit fee, or other charge for the privilege of using its streets or highways, other than a permit fee for extra legal loads ..."

Thus, when calculating service and regulatory fees, caution is advised when attempting to account for wear and tear on public roadways. Because Kern County's fee was imposed on multiple bases, the Court of Appeal remanded to the trial court to determine the portion of the fee to be invalidated under Vehicle Code § 9400.8.

In *Pajaro Valley Water Management Agency v. Amrhein*, 150 Cal.App.4th 1364 (2007), the 6th District Court of Appeal in San Jose ruled that a groundwater extraction charge levied to fund groundwater basin replenishment and other water supply programs was a property related fee subject to Proposition 218. While the case will be of most significance for groundwater management agencies and those who pay charges to those agencies, it also provides some guidance for local governments which wish to fashion regulatory fees exempt from Prop. 218.

The trial court found the fee to be exempt from Prop. 218 and gave judgment to the Agency. Initially, the Court of Appeal affirmed, concluding that the fee in issue was not property related. That decision, however, came two days after the California Supreme Court decided *Bighorn-Desert View Water Agency v. Verjil*, 39 Cal.App.4th 205 (2006), concluding that charges for metered water service were property related fees subject to Prop. 218. Because the reasoning of the initial appellate decision in the *Pajaro Valley* case was inconsistent with *Bighorn*, the 6th District granted rehearing and reversed the trial court.

The two-judge majority in the case concluded that the fee was not a special tax primarily because the cases cited by the opponents of the fee holding other kinds of revenues were taxes were not on point. Agencies which wish to distinguish a revenue measure from a tax should note several crucial aspects of the charge in issue here: the amount of the charge did not exceed the cost of the regulatory program it funded, fee proceeds could only be used to fund that program, and fee payors benefit from the program and create the environmental problems it addresses – the fee was imposed on those who pump groundwater and not merely those who own property or reside in the area served by the Agency.

Next, the majority concluded that the charge was not an "assessment" because it is not secured by an automatic lien on property, but could become a lien only as a judgment lien following a debt action. Prop. 218 defines the assessments it regulates as "a levy or charge *upon real property*."[3] The charge in issue here is not imposed on real property and collected via the

[3] California Constitution, Art. XIII D, § 2(b).

tax roll, but billed to those who operate groundwater wells, many, but not all, of whom are property owners. The Court rejected the fee opponents' claim that, because the charge had a capacity component (*i.e.*, a charge for existing or planned capital facilities[4]) it was necessarily an assessment, citing *Richmond v. Shasta Community Services District*, 32 Cal.4th 409, 422 (2004), which had rejected this same argument in a case holding that connection charges for new development are not property related fees subject to Prop. 218.[5]

The Court did conclude that the Agency's fee was a property related fee subject to Proposition 218. It noted the tension between the *Bighorn* ruling that water service charges are subject to Prop. 218 and the decision in *Apartment Ass'n of Los Angeles County, Inc. v. City of Los Angeles*, 24 Cal.4th 830 (2001). In that earlier decision, the California Supreme Court ruled that a property-tax-roll fee on landlords to fund housing code enforcement was not imposed "as an incident of property ownership" but on voluntary decisions to operate rental housing businesses. Voluntary decisions of that sort can be subject to non-Prop. 218 fees to fund business regulation. Thus, the question was: Is the *Pajaro Valley* fee more like a water service charge or more like a regulatory fee on those engaged in the extraction of groundwater in a manner that is causing discernible harm?

The Court concluded that this fee was not a regulatory fee, but a water-service fee subject to Prop. 218 under *Bighorn*. The Court appeared to be swayed by the fact that the fee was imposed on 660 agricultural users and 3,000 residential well owners and that, while the majority of the fees were paid by farms, there was no exemption for water consumed for domestic use by residents. From the Court's perspective, the fee an urban water user pays for metered service is not meaningfully different from the fee a rural well operator pays for groundwater replenishment and both fees should be subject to Prop. 218. The Court did note that a fee on those who consume more water than needed for domestic use would not be subject to Prop. 218, and that a fee on those who produce water for agricultural use would likewise be outside the measure. The Court also suggested that the fee might have been non-property related and exempt from Prop. 218 if it had a clearer regulatory purpose.

Some practical advice can be extracted from the *Pajaro Valley* decision:

First, a defensible regulatory fee that is not intended to be subject to Prop. 218 should:

- be labeled as a regulatory fee when it is adopted;

[4] Gov't Code § 66013(b)(3): "'Capacity charges' means charges for facilities in existence at the time the charge is imposed or charges for new facilities to be constructed in the future that are of benefit to the person or property being charged." Note the amendment to this section effective January 1, 2008 discussed in section 10 of this paper above.

[5] The author of this paper was counsel for the successful local government in the *Richmond* case.

- be imposed on a regulated action (like pumping groundwater) and not on a property or property owner solely due to property ownership;

- provide regulatory incentives to engage in less of the activity which has negative consequences the regulation seeks to address – *e.g.*, to use less lead in paint or to consume less water from an over-drafted groundwater basin. While this fee design is not mandatory, the *Pajaro Valley* decision shows that it can be helpful in excluding a fee from the sweep of Prop. 218.

Second, the case has consequences for water rates:

- In light of *Bighorn*, public lawyers have advised agencies to provide a cost-justification for rate structures which impose consumption block rates, which encourage conservation by charging progressively higher rates for larger amounts of water consumed. Such a justification could point to the varying costs of various water sources in an agency's portfolio of supplies and assign the cheapest water supply to the most efficient users of water. *Pajaro Valley* suggests that such a justification may not be necessary and that a purely regulatory motive to discourage inefficient use of limited water supplies may be enough. It is advisable to do both: demonstrate a cost justification for consumption block rates and state a regulatory purpose to discourage waste.

- It may be helpful to justify on expressly regulatory grounds aspects of water rate structures which have regulatory purposes – like consumption block rates, fines for unreported water leaks, and the like.

- As capacity charges can be defended against a Prop. 218 challenge on grounds different from those applicable to a water service charge, it may be helpful to state these charges separately in a water rate structure or at least to clearly identify the capacity component of the overall rate.

Third, as to the power to impose a lien on property to enforce delinquent charges, this power may make a court more likely to identify the underlying fee as an assessment or a property-related fee subject to Prop. 218. The value of this means of collection can be very great, especially in low-income communities where delinquency rates might otherwise be very high. This trade-off now bears thought when a fee ordinance is drafted. However, no risk of a Prop. 218 problem arises from enforcement via liens that follow debt actions in court, perhaps small claims court.

Fourth, use of the property tax roll creates a presumption that a fee is property related.[6] According to the *Pajaro Valley* court, however, use of the tax roll to identify a property owner as the person presumed to be engaged in a regulated activity does not alone make the fee property related and subject to Prop. 218. However, a presumption that a property owner is engaged in regulated activity must be subject to rebuttal. That is, if the agency will bill a tenant or other user of property instead of the property owner on a showing the owner is not engaged in the regulated activity (as operating the well in the *Pajaro Valley* case), the fee will not necessarily be subject to Prop. 218. Thus, collecting a charge on the property tax roll creates a substantial risk that a court will conclude that that the charge is a tax, assessment, or property-related fee and subject to one or another of the provisions of Prop. 218 requiring voter or property-owner approval for the charge.

Fifth, *Pajaro Valley* tells us that a consequence of the *Bighorn* decision is that the notice of a proposed fee or fee increase under Prop. 218 need not be of the "amount" a person will pay (as the text of Prop. 218 states),[7] but of the "rate" that will be used to determine that amount. While this would seem to be the only way to give notice of the sums a fee-payor can expect to pay, it is comforting to have a published appellate opinion to cite on this point. Thus, it is a good idea to include a rate table in a Prop. 218 notice of a utility rate increase so that all the rates to be charged, including any inflation-adjustment or pass-through of wholesale charges or other costs reflected in the rate structure, are presented to property owners in the protest proceeding.

Another case of interest is *California Farm Bureau Federation v. California State Water Resources Control Board*, 146 Cal.App.4th 1126, *review granted* April 16, 2007. In an effort to balance the State's 2003-04 budget, the Legislature reduced funding for the programs of the Division of Water Resources and ordered the State Water Resources Control Board (SWRCB) to adopt fees on holders of water rights permits and licenses issued by the Board and federal water contractors to fund the Division's programs. The Board did so, imposing a minimum fee of $100 per water rights holder and structuring fees based on the maximum volume of water a permit or license authorized its holder to use. A number of individual water rights holders and associations sued, arguing that these fees amount to taxes which require ⅔-approval of the each house of the Legislature under Proposition 13. California Constitution, Article XIII A, § 3.

The Third District Court of Appeal upheld the legislation authorizing the fees, and found the $100 minimum fee to be reasonable, but invalidated the remainder of the fees, finding that they did not sufficiently reflect the cost of the regulatory services for which they were imposed to pass muster as regulatory fees rather than taxes. The Court reached this conclusion because (i) the Board provides services to holders of pre-1914, riparian and pueblo rights which are not subject to the Board's permitting and licensing power and which account for 38% of water

[6] California Constitution, Art. XIII D, § 6(b)(5) ("Reliance by an agency on any parcel map, including, but not limited to, an assessor's parcel map, may be considered a significant factor in determining whether a fee or charge is imposed as an incident of property ownership for purposes of this article.")
[7] Art. XCIII D, § 6(a)(1).

diversions in the state, leaving the holders of rights to the remaining water to fund the entire cost of the Board's program and (ii) the Board cannot impose fees on the federal government and its agencies, which control 22% of water rights in the state, and cannot shift the cost of its services to federal contractors in lieu of imposing regulatory fees on the federal government itself.

The California Supreme Court granted review of the case, which means the appellate decision is no longer citable authority. Decision is not likely until 2008.

S.B. 258 (Ducheny, D- San Diego) is a two-year pending in the Assembly which would require the SWRCB to submit a report to the Legislature in conjunction with the Governor's 2008-09 budget identifying alternative means to finance the work of the Board.

14. Building and Land Use Permit Fees

Two recent cases address fees charged for building and planning permits and inspections. First is *Collier v. City and County of San Francisco*, 151 Cal.App.4th 1326 (2007). The case challenged the City's use of a surplus in building permit fee revenues to fund the Planning Department's long-range planning costs (the development of general plan amendments and specific plans) and the Fire Department's implementation of a fire sprinkler ordinance by inspecting multi-family residential structures and single-room occupancy hotels. The Court of Appeal upheld the diversion of these funds from the Building Department on the ground that the uses of the funds were reasonably germane to the purposes for which the fees were imposed.

The Court found a sufficient relationship between the purposes for which building permit fees are imposed and the expenditures due to the involvement of the Planning and Fire Departments in the process of issuing building permits, with Planning Department confirming general plan consistency and the Fire Department reviewing permits for Fire Code compliance. The Court noted that Gov't Code § 66014(b) allows the cost of adopting a general plan to be recovered from those who obtain building permits for new development under that plan. The court also stated that it was sufficient that the revenue devoted to the Planning and Fire Departments was proportionate to the burdens the building permitting program imposed on those departments and there was no need to show that any particular permittee imposed burdens on those departments in proportion to the portion of his or her fees devoted to those departments.

This case contrasts to some extent with the analysis of the *California Farm Bureau* case discussed in section 13 of this paper above and it will be interesting to see what light the Supreme Court sheds on these issues when it decides that case. The result of the case may have been influenced by the fact that it arose in a labor-relations context – the plaintiffs were associated with the union representing Building Department employees.

Also contrasting somewhat with the *Collier* case is *County of Orange v. Baratt American, Inc.*, 150 Cal.App.4th 420 (2007. Barratt American is a frequent litigant of building and land use

fees and, in this case, persuaded the trial court to accept accounting expert testimony that the County's building permit fees were unreasonably high. It is difficult to set building and land use fees to cover the cost of regulating development activity, because the level of development activity is difficult to predict. Thus, fee revenues rise and fall with the economic cycle and agencies frequently run deficits and surpluses. Provided that surpluses are used to reduce fees in future years, the amount of a fee is defensible notwithstanding the existence of a temporary surplus.

At issue in this case were Orange County's efforts to reduce an $18.5 million dollar surplus. The County reduced fees by $7.5 million, identified additional expenses of $5.8 million, and spent $5 million on a new computer system. The trial court accepted an accounting expert's conclusion that the cost increases, which appeared to relate to a decision to retain experienced building inspectors and other staff, rather than lay them off, only to have to recruit their replacements when building activity rose again. The Court of Appeal affirmed. Thus, the case is a troubling example of the courts allowing an accounting "expert" to second-guess an elected legislative body's decision about how to balance the costs and benefits to a regulatory program in setting fees from year to year.

The Court of Appeal concluded the County could spend the surplus rather than lower fees if the expenditures served to reduce fees in the future, that the County bore the burden to prove the reasonableness of its fees, and that substantial evidence supported the trial court's factual finding that the fees were excessive and its attorney's fee award. The Court ordered the County to reduce fees by an additional $4.5 million, refund fees to Barratt American, and to pay attorneys fees to Barratt's contingency counsel.

Thus, land use agencies are well advised to monitor surpluses in building and land use permitting fee revenues and to reduce fees or expend surpluses in ways plainly tied to program costs. Large surpluses that attract public attention and hasty efforts to "burn off" surpluses create a substantial risk of judicial second-guessing of the sort that occurred here.

15. Assessments under Proposition 218

Another question pending before the California Supreme Court is: Does regional open space provide special benefit to private property sufficient to justify assessment financing? The case raising this issue, awaiting an argument date as this paper is written, is *Silicon Valley Taxpayers Ass'n v. Santa Clara County Open Space Auth.*, Case No. S136468. In this case, the Authority imposed an assessment under the 1972 Landscaping and Lighting Act to fund a program of future, regional, open-space acquisitions. Because the acquisitions were prospective and the Authority did not want to reveal to landowners exactly how much it might pay for a given site, the engineer had an unusual task in demonstrating special benefit to private property from unspecified, future acquisitions and calculating the proportionate benefit attributed to each property owner in the District from such acquisitions. After twice vacating argument dates *sua*

sponte, the 6th District Court of Appeal in San Jose found, over Justice Bamattre-Manoukian's lengthy dissent, that the unspecified, future regional open space acquisitions sufficiently benefited property to justify assessment and that the spread of benefit was properly determined. Also in issue in the case was the Authority's rejection of ballots submitted on photocopies of an opposition leader's ballot, rather than on official ballot forms, an issue as to which the Authority's ballot-handling resolution was silent. The California Supreme Court granted review of the case, perhaps inspired by Justice Bamattre-Manoukian's dissent.

An opinion in the case is not likely until 2008. In the meantime, *Not About Water Comm. v. Solano County Board of Sups.*, 95 Cal.App.4th 982 (2002) is comparable authority that judicial review of special benefit decisions is relatively deferential and reliant on pre-Proposition 218 case law.

Another recent assessment decision exemplifying this judicial deference to determinations of special benefit has been the subject of a "grant and hold" order by which the Supreme Court grants review and suspends briefing pending decision of a lead case, in this case, the *Silicon Valley* case. This is *Dahms v. Downtown Pomona Property and Business Improvement District*, 41 Cal.Rptr. 3d 196, review granted July 12, 2006. The Second District Court of Appeal upheld Pomona's spread of the costs of a property-based Business Improvement District (PBID), allowing exemptions for non-profit entities, giving main street foot-frontage greater weight than rear- and side-yard street frontages in the assessment formula, and treating PBID services as necessarily providing special benefit because they were above and beyond the general level of City services. The Court of Appeal's decision was apparently influenced by the quality of argumentation by the plaintiffs' counsel. Like the *Silicon Valley* case, however, it may be an example of too-broad a victory for local government generating a grant of review by what remains a conservative California Supreme Court. The fact that the Court granted review and held briefing pending decision of the *Silicon Valley* case is suggestive that the Court views that case as broadly significant for all kinds of assessments under Prop. 218.

16. Assessments on State Property

A few years ago, the Legislature ordered the Department of General Services to augment the State Administrative Manual with guidance for managers of State real estate assets on how to pay local government assessments pursuant to Proposition 218. As of June 2005, the DGS has done so. Section 1310.5 of the Manual now states:

> Upon receipt of an invoice, statement, tax bill or other notification with a line item assessment or information pertaining to the development of an Assessment District, all State agencies are required to review the information and obtain its legal council's (sic) opinion in determining if the Assessment District was constituted pursuant to the procedures prescribed by law and further evaluate whether or not the state property within the District receives a special benefit.

> Agencies receiving bills from Districts constituted prior to 1996 should verify that the Districts have gone back and followed the procedures established in current law which would allow the State's participation. If the validity test is met, then the state agency which owns or controls the property is required to promptly pay its share of the assessment.

There is room for argument whether the State can reserve to itself the power to second-guess an assessment determination without appearing at the hearing and submitting evidence, as other property owners must do, but at least it appears the State recognizes its duty to pay local assessments which benefit State real estate assets.

17. Assessment Litigation Procedures

Bonander v. Town of Tiburon, 147 Cal.App.4th 1116 (2007), *reviewed granted* May 16, 2007, rejected a property owner's challenge to a utility-line-undergrounding assessment due to the failure of plaintiff (an attorney suing *in pro per*) to pursue his action under the validating statute of C.C.P. § 860 et seq. and to meet the short deadline for filing under that statute. Because the California Supreme Court granted review of the case, it cannot be cited as precedent, but the appellate ruling was a helpful reiteration of the rule that challenges to revenue measures which back debt must be pursued via validation and filed within 60 days of the action challenged. In particular, the appellate court rejected a claim that the adoption of Proposition 218 relaxed these requirements. The author of this paper and Amy Sparrow of Colantuono & Levin are writing an *amicus* brief in the case on behalf of the League of California Cities and the California State Association of Counties.

18. Prop. 218 Initiatives to Repeal or Reduce Revenue Measures

Another area of controversy under Proposition 218 is the scope of the initiative power created by Article XIII C, § 3, which provides:

> "Initiative Power for Local Taxes, Assessments, Fees and Charges. Notwithstanding any other provision of this Constitution, including, but not limited to, Sections 8 and 9 of Article II, the initiative power shall not be prohibited or otherwise limited in matters of reducing or repealing any local tax, assessment, fee or charge. The power of initiative to affect local taxes, assessments, fees and charges shall be applicable to all local governments and neither the Legislature nor any local government charter shall impose a signature requirement higher than that applicable to statewide statutory initiatives."

Among the questions this language raised were: Is a Prop. 218 initiative limited to assessments, fees and charges as those terms are defined in Article XIII D or may it extend to assessments not imposed on property, such a those in issue in *Evans v. San Jose*, 3 Cal.App.4th

728 (1992) (non-property-related business improvement assessment collected as surcharge on business license tax), or non-property-related fees? Can a Prop. 218 initiative exercise a rate-setting power delegated directly to a legislative body in contravention of *Committee of Seven Thousand v. Superior Court*, 45 Cal.3d 491 (1988)? To impair an essential governmental function in contravention of *City of Atascadero v. Daly*, 135 Cal.App.3d 466 (1982) (pre-Prop. 62 measure defining "special tax" and requiring voter approval invalid as impairment of fiscal management abilities)? To effectively disestablish an agency without complying with the Cortese-Knox-Hertzberg Act?

Bighorn resolves some of these questions, but leaves others to be decided by future cases. *Bighorn* reserved for another day whether the fees and charges subject to initiative repeal or reduction by Article 13 C are limited to the property-related fees governed by Article 13 D or whether other fees can be reduced by voters, as well. The Court did, however, make clear that all property related fees – including water, sewer and government trash service charges – may be reduced or repealed by initiative. 39 Cal.4th at 216.

The fact that the Legislature has delegated rate-setting power directly to a local legislative body does not alter this rule because Proposition 218 amended the state Constitution and binds the Legislature. *Id.* at 217.

While rates may be reduced or repealed by initiative, the Court invalidated a provision of the *Bighorn* measure which required ⅔-voter approval for future rate hikes, ruling that an initiative under Proposition 218 cannot make new rules for the adoption of revenue measures. *Id.* at 219. This is less helpful to local governments than it appears, however, as the Court noted that Elections Code § 9323 requires voter approval for changes to an initiative measure once approved by voters. *Id.* Therefore, if a rate reduction initiative is adopted by voters, it can be amended by the local agency's legislative body only to the extent the initiative measure expressly allows it to do so. Thus, a rate-reduction initiative will often become a rate cap, as well. On this issue, the Court stated:

> "by exercising the initiative power, voters may decrease a public water agency's fees and charges for water service, but the agency's governing board may then raise other fees or impose new fees without voter approval. Although this power-sharing arrangement has the potential for conflict, we must presume that both sides will act reasonably and in good faith and that the political process will eventually lead to compromises that are mutually acceptable and both financially and legally sound." *Id.* at 220.

The Court does not explain how an agency can "raise other fees or impose new fees without voter approval" without amending or violating an initiative that reduced rates. Can there be two rates for the delivery of water?

Many state statutes require water rate-setting bodies to set rates high enough to cover the cost to provide an adequate and safe water supply. The Court pointed out that it was not deciding whether voters acting by initiative can be held to such rules. *Id.* at 221. The fact that the Legislature is subject to Proposition 218's rules suggests voters might not be. On the other hand, in general, voters acting via initiative have no more power than does a City Council, Board of Supervisors or special district Board of Directors. That would suggest voters cannot set a rate too low to provide a safe and adequate water supply.

Another issue not addressed in the decision has to do with rate covenants in revenue bonds. These are promises to those who buy revenue bonds issued by a public utility that the utility will maintain utility rates high enough to maintain utility infrastructure and to pay the interest and principal of the bonds. These promises are binding contracts protected by the impairment of contracts clause of the federal Constitution and a rate-reduction initiative that violated such a covenant would likely be invalid.

19. Debt Limitation

Article XI, § 1 of the California Constitution requires a ⅔-vote of each house of the Legislature and voter approval for state action to borrow more than $300,000. A similar provision applies to local governments under Article XI, § 18. There are three exceptions to this requirement: for debt to be paid only from a special fund with no claim on an agency's general fund (like a water revenue bond); for contingent liabilities, like financing leases, where the agency can decide in any year to terminate the lease; and for obligations imposed on an agency by law – like a judgment bond to pay off liability under a lawsuit, or a bond issued to fund an activity mandated to local government by state or federal law. This third exception was at issue in *State of California ex rel. Pension Obligation Bond Committee, v. All Persons Interested*, 152 Cal.App.4th 1386 (2007). The Third District Court of Appeal invalidated bonds to be issued in conjunction with the 2003 budget to finance a portion of the state's obligation to fund pensions for state employees, finding that the obligation to fund pensions was not "an obligation imposed by law," but an obligation voluntarily undertaken by the Legislature.

Conclusion

Plainly, the pace of legal developments under Propositions 13, 62, and 218 is not slowing down more than 10 years after the approval of the latest of those measures. As always, we'll keep you posted!