S224779

IN THE SUPREME COURT

OF THE STATE OF CALIFORNIA

Citizens for Fair REU Rates, et al

Plaintiffs and Appellants,

v.

City of Redding, et al

Defendants and Respondents,

HOWARD JARVIS TAXPAYERS ASSOCIATION'S APPLICATION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE AND BRIEF OF AMICUS CURIAE IN SUPPORT OF APPELLANTS

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

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

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APPLICATION FOR LEAVE TO FILE

Howard Jarvis Taxpayers Association ("HJTA") is a California nonprofit public benefit corporation with over 200,000 members. The late Howard Jarvis, founder of HJTA, and Paul Gann, founder of Paul Gann's Citizens Committee (which merged with HJTA in 1999), utilized the People's reserved power of initiative to sponsor Proposition 13, which was overwhelmingly approved by California voters in 1978, adding article XIII A to the California Constitution. Proposition 13 has kept thousands of fixed-income Californians in their homes by limiting the rate and annual escalation of property taxes, which become liens if the property owner cannot afford to pay them.

In 1996, California voters enacted Proposition 218, which was also authored and sponsored by HJTA. Proposition 218 was known as the Right to Vote on Taxes Act, and added articles XIII C and XIII D to the California Constitution. Among other things, Proposition 218 places strict limitations on local governmental entities' authority to levy fees and charges for property-related services. Specifically, Proposition 218 subjects fees for property-related services to a "cost of service" requirement, and places the burden of establishing the validity of such fees on the government. Prior to its passage in 2010, HJTA participated in the drafting

process of Proposition 26.

On the general merits of this case, HJTA strongly supports Appellants and urges this Court to affirm the majority opinion of the Third District Court of Appeal in every respect. The vast majority of issues herein are thoroughly and excellently briefed by Appellants. HJTA respectfully requests leave from this Court to file the accompanying Brief of Amicus Curiae in order to lend its expertise as author and sponsor of both Propositions 13 and 218, specifically regarding historical context and legislative intent. Furthermore, HJTA successfully litigated two cases that guide the analysis in the present matter: *Howard Jarvis Taxpayers Assn. v. City of Roseville* (2002) 97 Cal.App.4th 637 and *Howard Jarvis Taxpayers Assn. v. City of Fresno* (2005) 127 Cal.App.4th 914.

Amicus HJTA's staff attorneys authored the entirety of the proposed brief, and Amicus HJTA neither made nor received any monetary contributions intended to fund the preparation or submission of the brief.

///

For these reasons, HJTA respectfully requests this Court's permission to file the accompanying Brief of Amicus Curiae.

Dated: August 19, 2105

Respectfully submitted,

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JONATHAN M. COUPAL
TIMOTHY A. BITTLE
J. RYAN COGDILL

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BRIEF OF AMICUS CURIAE

I

INTRODUCTION

Amicus Howard Jarvis Taxpayers Association ("HJTA") strongly supports Appellants Citizens for Fair REU Rates, et al (hereafter, "Citizens") and urges this Court to affirm the decision of the Third District Court of Appeal. While Appellant has more than sufficiently briefed the relevant issues presented, Amicus writes separately to share its expertise as the drafter and sponsor of Propositions 13 and 218, and as a contributor to the drafting of Proposition 26.

Proposition 26 was a response by the People of California to unfair and underhanded tactics by state and local governmental entities seeking to circumvent the constitutional limitations imposed on revenue generation methods such as property taxes, assessments, and fees for property-related services. Specifically, the voters sought to rein in the wanton abuse of taxes masquerading as fees. But local governments remain undeterred, and continue to chip away at the constitutional protections the People have seen fit to establish for themselves.

Nothing in Proposition 26 prevents the Respondents City of Redding (hereafter, the "City") from collecting from its electrical utility ratepayers

costs that its general fund incurs to administer the municipal electrical utility. However, our Constitution requires that any cost allocation methodology purporting to capture such costs must reasonably reflect actual costs incurred by the City. Because the payment in lieu of taxes ("PILOT") at issue here bears no reasonable relationship to the costs it purports to capture, it is plainly unreasonable. Accordingly, the City cannot meet its burden and the PILOT is an unlawful tax.

II

LEGISLATIVE BACKGROUND OF PROPOSITIONS 13 , 218, & 26

In 1978, California voters overwhelmingly passed Proposition 13, which was authored and sponsored by HJTA founder Howard Jarvis and his partner Paul Gann. In passing Proposition 13, the People of California intended to strictly limit the taxing authority of local governmental entities. (*City of San Diego v. Shapiro* (2014) 228 Cal.App.4th 756, 761-62.) One mechanism by which Proposition 13 accomplished this was to cap ad valorem property tax rates. (Cal. Const., art. XIII A, sec. 1, subdiv. (a).)

In order to circumvent the restrictions imposed on their taxing authority by Proposition 13, many local government entities began charging new or higher fees, charges, and assessments. (See *Town of Tiburon v. Bonander* (2009) 180 Cal.App.4th 1057, 1072-74.) One common practice

was for local government entities to pad utility bills with charges far in excess of the cost to provide the property-related service. To remedy these and other abuses, HJTA authored and sponsored Proposition 218:

> "In adopting this measure, the people found and declared that Proposition 13 was intended to provide effective tax relief and to require voter approval of tax increases. However, local governments have subjected taxpayers to excessive tax, assessment, fee and charge increases that not only frustrate the purposes of voter approval for tax increases, but also threaten the economic security of all Californians and the California economy itself. This measure protects taxpayers by limiting the methods by which local governments exact revenue from taxpayers without their consent."

(*Howard Jarvis Taxpayers Assn. v. City of Roseville* (2002) 97 Cal.App.4th 637, 640 (internal quotation marks omitted) (hereafter *Roseville*); citing Historical Notes, 2A West's Annotated California Constitution (2002 supp.) following article XIII C, section 1, page 38.)

Proposition 218 limits the authority of local governmental entities to levy property-related fees and charges. It specifically provides:

> "A fee or charge shall not be extended, imposed, or increased by any agency unless it meets all of the following requirements:
>
> "(1) Revenues derived from the fee or charge shall not exceed the funds required to provide the property related service.

> "(2) Revenues derived from the fee or charge shall not be used for any purpose other than that for which the fee or charge was imposed. [...]
>
> "(5) No fee or charge may be imposed for general governmental services including, but not limited to, police, fire, ambulance or library services, where the service is available to the public at large in substantially the same manner as it is to property owners. [...] In any legal action contesting the validity of a fee or charge, the burden shall be on the agency to demonstrate compliance with this article."

(Article XIII D, sec. 6, subdiv. (b) [emphasis added].)

In light of Proposition 218's new restrictions on fees, charges, and assessments, local governments again sought to circumvent constitutional restrictions on revenue generation and began broadening the scope of fees. The consequence of this trend, as well as this Court's landmark decision in *Sinclair Paint Co. v. State Board of Equalization* (1997) 15 Cal.4th 866, was that the voters elected to enact Proposition 26 in 2010. (*Schmeer v. County of Los Angeles* (2013) 213 Cal.App.4th 1310, 1322.) "Proposition 26 expanded the definition of taxes so as to include fees and charges, with specified exceptions; required a two-thirds vote of the Legislature to approve laws increasing taxes on any taxpayers; and shifted to the state or local government the burden of demonstrating that any charge, levy or assessment is not a tax." (*Id.*)

III

THE PILOT IS A "TAX" FOR THE PURPOSES OF PROPOSITION 26

The first question certified by this Court asks whether the "payment in lieu of taxes (PILOT) transferred from the city utility to the city general fund [is] a 'tax' under Proposition 26 (Cal. Const., art. XIII C, sec. 1, subd. (1)(e))".

Proposition 26 redefines a "tax" imposed by a local governmental entity as "any levy, charge, or exaction of any kind imposed by a local government" subject to seven enumerated exceptions. (*Id.*) The exception at issue in the instant case excludes from the definition of a tax "charge[s] imposed for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of providing the service or product." (Cal. Const., art. XIII C, sec. 1, subd. (e)(2).) "The local government bears the burden of proving by a preponderance of the evidence that a levy, charge, or other exaction is not a tax, that the amount is no more than necessary to cover the reasonable costs of the governmental activity, and that the manner in which those costs are allocated to a payor bear a fair or reasonable relationship to the payor's burdens on, or benefits received from, the governmental activity." (Cal. Const., art. XIII C, sec. 1, subd.

(e).) Thus, as the appellate court correctly noted, the PILOT at issue here is a tax unless the City affirmatively demonstrates that it does not exceed its costs to the general fund to provide electrical utility service. (*Citizens for Fair REU Rates v. City of Redding* (2015) 233 Cal.App.4th 402, 410-12.)

Given that Proposition 26 is a relatively recently enacted law, it is unsurprising there is no relevant case law construing the reasonable cost requirement. However, as both the Third District and Citizens have demonstrated, there are cases construing analogous provisions of Proposition 218 applicable to non-electricity utility rates that are instructive to the case at bar. In *Roseville*, the Third District considered an "in-lieu franchise fee" charged by the City of Roseville to three municipal utilities. The fee, which was incorporated into charges on utility bills, was intended to reimburse the city for general fund costs related to the utility's use of city streets, alleys, and rights of way. (*Roseville*, 97 Cal.App.4th at 639-40.) The fee was calculated as a flat 4% of the annual budget of each utility and was deposited in the city's general fund. (*Id.* at 638.) The court determined that the in-lieu fee was a fee for property-related service subject to the limitations of article XIII D, section 6(b) and that such costs theoretically may be recovered from ratepayers. However, the court held that Roseville's fee was invalid because the city failed to establish it "reasonably

represent[ed] the cost of providing service":

> "Roseville sets the in-lieu fee at a flat 4 percent of each of the three utilities' annual budgets. **On its face, this fee does not represent costs. It is a flat fee. It is imposed on the utilities' budgets, presumably after their total costs have been accounted for in the budget process**. If the budget of a utility increases because of a cost increase unrelated to the in-lieu fee, the in-lieu revenues, as a flat percentage of that increased budget, increase as well. The in-lieu fee is the same percentage applied to each budget, regardless of varying uses of streets, alleys and rights-of-way by the individual utilities. **It cannot be said that this flat fee on budgets coincides with these costs**.
>
> "Roseville concedes that the in-lieu fee was set at 4 percent 'of utility expenses by a process that considered (1) what [Roseville] collects as franchise fees from private enterprises, (2) what other communities collect as franchise fees, and (3) what would be a reasonable rate of return for use of [Roseville's] rights[-]of[-]way.' As plaintiffs point out, however, not one of these factors aligns with an identified cost of providing utility service, as required by Proposition 218; instead, they all ask, '"'What will the market bear?'"' **While Roseville may be free to impose franchise fees on private utilities on the basis of contractual negotiation rather than costs, it is not free, under section 6(b) of Proposition 218, to impose franchise-like fees on a noncost basis regarding its municipal utilities**."

(*Roseville*, 97 Cal.App.4th at 648 [emphasis added].)

Three years later, the Fifth District considered a similar challenge to an "in lieu fee" imposed by the City of Fresno on each of its municipal utilities. (*Howard Jarvis Taxpayers Assn. v. City of Fresno* (2005) 127 Cal.App.4th 914) (hereafter, *Fresno*.) In circumstances mirroring the case at bar, this in lieu fee was designed to capture the "property and other taxes normally placed on private business" and was calculated as one percent of "the assessed value of fixed assets of the utility". (*Id.* at 917.)

In considering the constitutionality of the in lieu fee in light of Proposition 218's passage, the court reasoned:

> "Before Proposition 218, a city did not need to be too precise in accounting for all of the costs of a utility enterprise, since the city was permitted (unless otherwise restricted by its charter) to make a profit on its utility operations in any event and rates were permitted to reflect the 'value' of the service, not just the cost of providing the service.
>
> "Proposition 218 changed all that with its constitutional requirement that revenues derived from the fee or charge shall not exceed the funds required to provide the property related service.
>
> "Cities are still entitled to recover all of their costs for utility services through user fees. The manner in which they may do so, however, is restricted by another portion of Proposition 218: The amount of a fee or charge imposed shall not exceed the proportional cost of the service attributable to the parcel.

> "Together, subdivision (b)(1) and (3) of article XIII [D], section 6, makes it **necessary-if Fresno wishes to recover all of its utilities costs from user fees-that it reasonably determine the unbudgeted costs of utilities enterprises and that those costs be recovered through rates proportional to the cost of providing service to each parcel. Undoubtedly this is a more complex process than the assessment of the in lieu fee and the blending of that fee into the rate structure. Nevertheless, such a process is now required by the California Constitution. The trial court correctly prohibited Fresno from collecting the outdated in lieu fee**."

(*Fresno*, 127 Cal.App.4th at 922-23.) (Emphasis added; internal quotations and citations omitted.)

The same reasoning ought to apply to the case at bar. While Proposition 26 does not contain precisely the same cost-of-service language that Proposition 218 does, they are conceptually identical. Like the in lieu fees in *Roseville* and *Fresno*, the PILOT imposed by the City bears no correlation to costs. There is simply no relationship, reasonable or otherwise, between Proposition 13's arbitrary one percent cap on ad valorem real property taxes and the actual costs incurred by the City in connection with its administration of the electrical utility. The valuation of the utility's assets, which are subject to the ebbs and flows of the market, in no way reflects actual costs incurred by the City on behalf of the utility. That this

figure represents the property taxes the utility would have paid if it were a private entity is a non sequitur.

It may be true that the City incurs costs legitimately incurred on behalf of the electrical utility, but the PILOT does not reasonably identify and capture those costs. To the extent the PILOT approximates actual costs, it is merely coincidence. And relying on coincidence is not fair or reasonable. Because the PILOT is totally arbitrary with respect to actual costs incurred by the City, the City has not and cannot meet the burden imposed upon it by article XIII C, section 1(e), and the PILOT must be considered an illegal tax. The majority opinion of the Third District was entirely correct when it remanded this case to the trial court for further factual determinations regarding actual costs. (*Redding*, 233 Cal.App.4th at 421-22.)

IV

THE EXCEPTION DOES NOT APPLY BECAUSE THE PILOT DOES NOT REASONABLY OR FAIRLY REFLECT THE ACTUAL GENERAL FUND COSTS INCURRED BY THE CITY ON BEHALF OF ITS MUNICIPAL UTILITY

The second question certified by this Court asks whether "the exception for 'reasonable costs to the local government of providing the service or product' apply to the PILOT (Cal. Const., art. XIII C, sec. 1,

subd. (1)(e)(2)".

For the reasons discussed in Section III, *supra*, the answer to this question must be no. The PILOT merely reflects the valuation of the utility's assets, and in no way correlates with actual costs incurred by the City on behalf of the Utility. Thus, the City has not and cannot meet its obligations under Proposition 26 to establish that one of the enumerated exceptions apply. Therefore, the PILOT is an unlawful tax that has not been approved by the voters.

V

THE PILOT IS INVALID FOLLOWING THE BUDGETARY PERIOD IN EFFECT WHEN PROPOSITION 26 BECAME LAW

The third and final question certified by this Court asks whether "the PILOT predate[s] Proposition 26."

The correct answer to this question is yes, though only as to the budgetary cycle in effect on the date Proposition 26 became effective. Because the PILOT was not codified and was merely a recurring item in the City's biennially approved budget, it has no continuing vitality following the end of the budgetary period that ended in 2011. For the same reasons, the City violated Proposition 26 when it increased the PILOT after the date Proposition 26 became effective but before the expiration of the budgetary

cycle ending in 2011. On this point, the majority opinion of the Third District is entirely correct in every respect:

> "The PILOT's regular appearance in Redding's budgetary process does not mean it was a permanent or continuing transfer compelled by ordinance or other non-discretionary authority. As a recurring discretionary part of the Redding biennial budget, the PILOT cannot be said to precede or be grandfathered-in under Proposition 26. And, the PILOT also cannot be said to be the product of legislation for which Proposition 218 provided a savings clause to allow 'fees and charges' to be brought into compliance by a certain date. Although Propositions 26 and 218 stand in pari materia—namely they relate to the same subject (*People v. Honig* (1996) 48 Cal.App.4th 289, 327)—nothing in either statute grandfathers in the PILOT simply because it has been a customary recurrence in the Redding municipal budget."

(*Redding*, 233 Cal.App.4th at 417-18.)

The decision of the trial court improperly blurred the lines separating free market participation and government coercion when it reasoned:

> "All businesses are required to pay taxes. Here, the City of Redding had the foresight to own and operate its own electric utility. As a result [i]t has utility rates that are comparatively lower than many others in the state. If there was a private company providing electric service, that company would be required to pay taxes to [Redding] for the services and benefits [Redding] provides. That expense would be passed on to customers as a cost of providing

> the service and product, and would not be subject to voter approval. The private utility could charge whatever rates it desired. Requiring [Redding] to put its electric rates out to vote every time a rate increase is necessary (because the rates include items that arguably are not 'directly related' to the cost of providing electricity) cannot reasonably be deemed to be an intended consequence of Proposition 26."

(*Redding*, 233 Cal.App.4th at 417-18.) Municipally owned utilities are not like private businesses, nor does our constitution treat them as such. Private businesses rely on the persuasion of consumers in order to transact business, while the invisible hand of the market corrects price inefficiencies. On the other hand, government owned utilities enjoy the full coercive power of the state over its monopolized territory.

Given the obvious distinctions between these two systems, the public policy arguments for treating municipally owned utilities differently are clear. Whereas a business must provide a quality product or service at a fair price in order to satisfy its customers and sustain its existence, a governmental entity exists in perpetuity by legislative fiat, free from the corrective influences of competition and financed via extractions from the populace backed by the heavy hand of the state. In light of this, it is easy to see why the People saw fit to reserve for themselves peremptory approval for all revenue increases save a narrow and enumerated selection of fees.

The People of California made clear and unequivocal public policy judgments when they passed Propositions 218 and 26 that municipal utilities should be limited to providing utility service at no more than cost, and that they should not be permitted to operate at a profit. Indeed, the "fee" hike at issue in this case is precisely this sort that proponents had in mind when designing Proposition 26, which, like Propositions 218 before it, was designed to increase voter participation on matters of public finance and enhance taxpayer consent. (See *Howard Jarvis Taxpayers Assn. v. City of Riverside* (1999) 73 Cal.App.4th 679, 683.)

Therefore, this Court ought to affirm the majority opinion of the Third District in every respect.

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VI

CONCLUSION

For the foregoing reasons, Amicus respectfully requests that this Court affirm the majority opinion of the Third District in its entirety.

Dated: August 19, 2015

Respectfully submitted,

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WORD COUNT CERTIFICATION

I certify, pursuant to Rule 8.204(c) of the California Rules of Court, that the attached brief, including footnotes, but excluding the caption pages, tables, and this certification, as measured by the word count of the computer program used to prepare the brief, contains 3,128 words.

Dated: August 19, 2015

Respectfully submitted,

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PROOF OF SERVICE

CALIFORNIA SUPREME COURT

I, Lorice Strem, declare:

I am employed in the County of Sacramento, California. I am over the age of 18 years, and not a party to the within action. My business address is: 921 11th Street, Suite 1201, Sacramento, California 95814. On August 19, 2015 I served the foregoing document described as: **HOWARD JARVIS TAXPAYERS ASSOCIATION'S APPLICATION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE AND BRIEF OF AMICUS CURIAE IN SUPPORT OF APPELLANTS** on the interested parties below, using the following means:

SEE ATTACHED SERVICE LIST

__X__ **BY UNITED STATES MAIL** I enclosed the document in sealed envelopes or packages addressed to the respective addresses of the parties stated below and placed the envelopes for collection and mailing, following our ordinary business practices. I am readily familiar with the firm's practice of collection and processing correspondence for mailing. On the same day that correspondence is placed for collection and mailing, it is deposited in the ordinary course of business with the United States Postal Service, in a sealed envelope with postage fully prepaid at Sacramento, California.

_____ **BY OVERNIGHT MAIL** I enclosed the document in sealed Federal Express envelopes addressed to the respective addresses of the parties stated below and placed the envelopes at a Federal Express drop off location.

__X__ **(STATE)** I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

Executed on August 19, 2015, at Sacramento, California.

Lorice Strem
Print Name of Person Executing Proof

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