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Government Code § 6103

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

Citizens for Fair REU Rates, et al.
Plaintiffs and Appellants
vs.
City of Redding, et al.
Defendants and Respondents.

Fee Fighter LLC, et al.
Plaintiffs and Appellants
vs.
City of Redding, et al.
Defendants and Respondents.

PETITION FOR 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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To the Honorable Chief Justice and Associate Justices of the California Supreme Court:

The City of Redding respectfully petitions for review of a published opinion of the Court of Appeal.

QUESTIONS FOR REVIEW

1. Does Proposition 26 — California Constitution, article XIII C, section 1, subdivision (e)[1] — retroactively invalidate earlier local legislation that increases the cost of a government service? If so, does that retroactive effect turn on the legislation's form (e.g. charter provisions, ordinances, resolutions, or budget provisions)?

2. Is a payment in lieu of property taxes (PILOT) imposed on a City's electric utility for the benefit of its general fund necessarily a reasonable cost of service under article XIII C, section 1, subdivision (e)(2) because it equals the tax an investor-owned utility would pay under Proposition 13 (Cal. Const., art. XIII A, § 1) and because rates which may fund it are significantly lower than rates of a neighboring investor-owned utility approved by the Public Utilities Commission?

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[1] All references to articles in this Petition are to the Constitution.

3. Are prices in wholesale power markets "imposed" under article XIII C, section 1, subdivision (e)(2) notwithstanding that those who pay such prices are sophisticated entities with substantial market power?

4. Does the statutory remedy for a violation of 1986's Proposition 62 apply to a PILOT lawful when enacted but later found to violate Proposition 26?

INTRODUCTION

This case presents an opportunity to answer significant questions pending in many lower courts considering Proposition 26. That 2010 initiative amendment to our California Constitution newly defines all revenue measures "imposed" by local governments as taxes requiring voter approval, with seven stated exceptions. (Cal. Const., art. XIII C, § 2, subd. (e).) It defines revenues imposed by the State as taxes requiring two-thirds approval of each legislative chamber, with five exceptions worded nearly identically to those provided for local government. (Cal. Const., art. XIII A, § 3, subd. (b).)[2]

Over Justice Duarte's dissent, the published opinion of the Third District ("the Opinion") applies Proposition 26 to invalidate a

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[2] There are very minor differences between article XIII C, section 1, subdivisions (e)(1) – (5) and XIII A, section 3, subd. (b)(1) – (5). None is material here.

payment in lieu of taxes ("PILOT") first legislated by the Redding City Council in 1988 and last amended in 2005. This case raises important issues under Proposition 26, including:

- whether the measure prospectively invalidates earlier legislation affecting the cost of government services,
- the meaning of "reasonable cost of service" — which also appears in Proposition 218 (art. XIII D, § 6, subd. (b)(1) & (b)(3))— and
- remedies for violation of either measure.

Further, although this Court does not review mere error, the published Opinion contains numerous factual and legal errors — uncorrected on denial of competing petitions for rehearing. It has already been criticized by the Second District. (*Jacks v. County of Santa Barbara* (Feb. 26, 2015, No. B253474) ___ Cal.App.4th ___ ("*Jacks*").) These facts counsel against delaying review to allow these issues to further develop in the lower courts. Absent review, the Opinion will mislead lower courts, the State, and local governments and waste public resources in duplicative litigation affecting many agencies — including 42 listed in footnote one to Justice Duarte's dissent which collectively represent the entire public power industry in California and which serve the great majority of its people.

The Opinion elevates form over substance by hinging its conclusion on the City's adoption of the PILOT by budget resolution rather than ordinance. Accordingly, under the Opinion, application

of Proposition 26 depends on the form rather than the substance of earlier legislation. The Opinion assumes — without analysis of the language or intent of the City's legislation — the PILOT was temporary because it was included in recurring budget resolutions, despite uncontroverted evidence the City Council intended the PILOT to be permanent. This overlooks the canon of construction that re-adoption of legislative language is construed to continue earlier legislation, not to re-adopt it. The Opinion concludes the PILOT expired with the budget in effect on Proposition 26's effective date. Thus the Opinion invents a new rule of legislative formalism that will have widespread impacts for both State and local governments; for the construction of Proposition 26 and related Propositions 13, 62 and 218; and for the application of other constitutional amendments or preemptive legislation.

The Opinion's conclusion also disserves the plain intent of voters to grandfather pre-Proposition 26 legislation. By the Opinion's logic, many state and local laws that increase utility costs by subsidizing rates for the poor and the elderly — or requiring safety or environmental protections — do not survive Proposition 26, despite ballot argument assurances to the contrary.

The Opinion also clouds the meaning of "reasonable cost of service" under Proposition 26. (Cal. Const., art. XIII C, § 1, subds. (e)(1) – (3).) The Dissent concludes a PILOT is a reasonable cost of publicly-owned utility service, just as privately-owned

utilities pay property taxes under Proposition 13. The Opinion holds otherwise, and erroneously concludes the PILOT itself must recover costs paid by the electric enterprise fund, as opposed to the cost of municipal services provided by the general fund.

The case also asks: under what circumstances is a charge for a government benefit or service "imposed" so as to trigger Proposition 26 — or Proposition 218, which uses the same term? The Opinion erred in finding that wholesale transactions between sophisticated entities with multiple power sources are subject to the same cost-of-service limitations of Proposition 26 as retail rates paid by customers who have no practical alternative to the City's utility. This published holding will have widespread impact on public power — effectively ceding that market to private parties unconstrained by Proposition 26.

Finally, this case presents the first opportunity to consider remedies under Proposition 62.

These questions are vital to the State and local governments alike. Moreover, each is pending in many lower courts. Review will allow this Court to authoritatively resolve these questions for the benefit of litigants, courts, and policymakers through California.

STATEMENT OF FACTS

From 1971 to 1988, the City implemented an operating transfer from Redding Electric Utility ("REU") to the City's general fund. This was a fixed amount established by budget; unlike a

PILOT, which is calculated like a property tax as a percentage of the value of utility assets. (II AR Tab 37, p. 358; II AR Tab 42, pp. 379–380; III AR Tab 111, p. 640.)[3] The transfer was intended to compensate the general fund for benefits and services to the utility (for which a private utility would pay via property taxes and franchise fees for use of public rights of way) in addition to services not provided to a private utility, such as billing, finance, and fleet maintenance. (II AR Tab 37, p. 358; I AR Tab 5, p.133.)

The City Council replaced the operating transfer with a PILOT upon adoption of the FY 1988–1989 budget. (II AR Tab 28, p. 319; III AR Tab 111, p. 640.) The PILOT was initially calculated by valuing REU's property, subtracting depreciation, and multiplying the result by Proposition 13's one percent property tax rate. (II AR Tab 42, p. 380.) The PILOT was amended to reflect evolving accounting practices three times — in 1991 (II AR Tab 70, pp. 446–447; II AR Tab 72, p. 450), 2001 (III AR Tab 126, pp. 693–694; III Tab 134, p. 738), and in 2005 (2 CT 530). The City has since implemented the PILOT without change.

In December 2010, the City Council adopted Resolution No. 2010-179 to increase electric rates by 7.84 percent, effective January 2011, and by another 7.84 percent effective December 2011. (IV AR Tab 163, p. 1041.) Although the utility's costs to generate

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[3] Citations to the Administrative Record are in this form: [Volume] AR Tab [#], p. [#].

electricity had increased significantly in earlier years; the City deferred rate increases, depleting reserves. (III AR Tab 140, pp. 797–800; IV AR Tab 159, p. 1031.) As a result, reserves fell significantly and staff warned that failure to raise raises would harm REU's credit rating and increase its borrowing costs. (IV AR Tab 165, p. 1060; IV Tab 166, p. 1077–1078.) Staff also recommended rate increases to reflect escalating costs and to honor bond covenants to maintain rates and cash reserves sufficient to ensure debt repayment. (IV AR Tab 158, p. 1028; IV AR Tab 159, pp. 1031–1033.)

The 2010 rate increases did not change the PILOT in any way. (IV AR Tab 163, p. 1041.) Nor were those increases necessary to fund the PILOT — REU's non-rate revenues are three to four times the PILOT amount. (IV AR Tab 145, p. 831; IV AR Tab 149, p. 873.) Thus, the PILOT can be funded from non-rate revenues. (IV AR Tab 145, p. 831; IV AR Tab 149, p. 873; XIII AR Tab 205, p. 2975.)

PROCEDURAL HISTORY

A. Two Writ Petitions

On February 4, 2011, Citizens for Fair REU Rates, an unincorporated association, sued the City and City Council of Redding (collectively, "City") in mandate and for declaratory and injunctive relief (Case No. 171377, "Rate Case"), alleging rates adopted by Resolution No. 2010-179 are "taxes" requiring voter

approval under Proposition 26 due to their inclusione of the PILOT. (1 CT 2.)

On August 29, 2011, Feefighter, LLC, a for-profit entity owned by Citizens' counsel, filed a second suit (Case No. 172960, "Budget Case") alleging Resolution No. 2011-111, which adopted the City's FY 2011–2013 budget, illegally reflected PILOT revenues and therefore violated Proposition 26. (2 CT 498.)

B. Trial Court Proceedings

The Superior Court tried the Rate Case November 8, 2011, ruling for the City. (3 CT 709.) The court concluded the PILOT was neither created nor altered by the December 2010 rate increase; Proposition 26 therefore does not apply to the PILOT, and cannot invalidate the rate increase. (3 CT 711.)

The court consolidated the two cases on February 2, 2012. (3 CT 719.)

On July 13, 2012, the Court issued judgment for the City in both cases. (3 CT 750.) The trial court concluded Proposition 26 does not apply retroactively to the PILOT, adopted in 1988. (3 CT 736, 739.) The trial court also concluded the PILOT is a lawful cost of service not displaced by Proposition 26. (3 CT 734-737.)[4]

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[4] A copy of the June 22, 2012 Memorandum of Decision is attached to this brief pursuant to California Rules of Court, rule 8.504, subd. (e)(1)(B).

Citizens for Fair REU Rates and Feefighter, LLC (collectively, "Citizens") appealed both judgments on August 20, 2012. (3 CT 760.)

C. The Opinion

The Opinion accepts the trial court's conclusion that Proposition 26 does not apply retroactively to local government charges adopted before its November 2010 effective date. (Opinion at p. 3.)[5] However, the Opinion determined the PILOT was subject to annual reauthorization by the City Council (*ibid.*),[6] and thus the PILOT grandfathered by Proposition 26 was the one adopted by the FY 2009–2011 budget — except any PILOT increase that may have resulted from the December 2010 rate increase. (Opinion at pp. 19–20.) The Opinion is thus ambiguous as to whether the PILOT became subject to Proposition 26 with the December 2010 rates (*ibid.*) or the June 2011 budget adoption. (Opinion at p. 19.) The City's petition for rehearing noted the ambiguity — to no effect. (Petn. for Rehg. at pp. 9–10.)

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[5] As required by California Rules of Court, rule 8.504, subd. (e)(1)(A), copies of the Opinion and the Dissent are attached to this brief, along with the Order Denying Rehearing.

[6] The Opinion contains a factual error on this point, in that the City's budgets are adopted every two years. This error was brought to the Court of Appeal's attention in the City's Petition for Rehearing. The modified Opinion maintains the error.

The Opinion concludes the PILOT reflected in FY 2011–2013 and subsequent budgets is new, post-Proposition 26 legislation and therefore a tax requiring voter approval unless the City demonstrates it is limited to cost of service as article XIII C, section 1, subdivision (e)(2) requires. (Opinion at p. 20.) The Opinion declines to address whether the PILOT reflects a reasonable cost to the City for services to REU, and remands that issue for trial. (Opinion at pp. 20–23.) Citizens' petition for rehearing objected to that remand to no avail. (Citizens Petn. for Rehg. at pp. 2–12.) Finally, the Opinion rejected the trial court's factual finding that the PILOT is funded by non-rate revenues, without explanation why the PILOT must be viewed as funded by rates. (Opinion at p. 14.) The Opinion rejected the City's contention that prices for its wholesale power sales are not "imposed" under Proposition 26. (Opinion at p. 14.) The City unsuccessfully sought rehearing on this issue, too. (Petn. for Rehg. at pp. 10–11.)

D. The Dissent

Justice Duarte dissented ("Dissent"), agreeing with the Opinion's conclusions the PILOT was readopted after November 2010 and therefore subject to Proposition 26. (Dissent at p. 2.) However, she concluded the PILOT is a "reasonable" cost allowed by article XIII C, section 1, subdivision (e)(2) because it reflects the property tax on private utilities limited by Proposition 13. (Dissent at p. 2.) As property taxes may be funded by rates of regulated

private utilities, a public utility may do the same under Proposition 26. (Dissent at p. 4.) The Dissent finds "legally-compelled" the trial court's conclusion the PILOT is a reasonable cost of service under article XIII C, section 1, subdivision (e)(2). (Dissent at pp. 4–5.)

E. Denial of Both Petitions for Rehearing

Both parties sought rehearing. The City identified factual errors, misstatements of the City's arguments, and errors of law. Citizens objected to remand and to the conclusion the PILOT models the property tax. The Court of Appeal denied both petitions on February 19, 2015 and ordered the Opinion modified to address one of the City's legal arguments and to correct a typographical error, but without change in judgment. This timely Petition follows.

I. REVIEW IS NECESSARY TO RESOLVE IMPORTANT QUESTIONS AFFECTING THE STATE AND ALL LOCAL GOVERNMENTS

The Opinion addresses important questions that affect every legislative body's power to make or maintain revenue measures under Propositions 13, 218, and 26. It misstates settled law, the facts of the case, and misinterprets Proposition 26. Review is necessary to correct these errors. Moreover, this Court should not await further appellate authority before addressing these questions, because the Opinion provides lower courts inappropriate guidance on pressing public finance matters affecting not only the public power industry,

but **all** state and local rate-making. Thus the Opinion's errors must be corrected now to avoid unnecessary disruption and litigation that may take years to resolve.

A. Guidance Is Needed on Retroactive Application of Proposition 26

Nearly all publicly owned utilities provide general fund support like that challenged here. (See Brief of Amicus Curiae California Municipal Utility Association ("CMUA Brief") at pp. 6–7; See also Dissent at p. 1, fn. 1.) Such transfers are so common the Legislature requires:

> All city-owned electric utilities shall report on the periodic bill the amount expected to be transferred from the utility to the general fund, and to any special funds, of the city on a no less than annual basis.

(Pub. Util. Code, § 9606.)

Electric utilities must also comply with many other legislatively imposed costs, including environmental regulation, safety requirements, and greenhouse-gas-reduction goals. Most were legislated before Proposition 26's adoption in 2010, but — because that measure limits rates for public services to the cost of service — continued vitality of these laws depends on whether Proposition 26 applies to pre-existing legislation.

It is plain that Proposition 26 is not retroactive as to local governments.[7] All four judges to review this case — the trial court, the majority and the dissent — agree on this point. (3 CT 736, 739; Opinion at p. 17, citing *Brooktrails Township CSD v. Board of Supervisors* (2013) 218 Cal.App.4th 195, 205–207; see also Dissent at p. 2, fn. 2.) However , it is less clear whether rate-making after Proposition 26 may account for costs to comply with legislation that predates it — the facts here. Thus, the State and all local governments need guidance as to the continuing validity of those earlier laws.

Grandfathered costs under Proposition 26 are disputed in many lower courts. To cite but two significant examples:

- 2006's A.B. 32, the greenhouse gas law, is subject to a Proposition 26 challenge to fees imposed by the California Air Resources Board to implement the law. (See Motion for Judicial Notice ("MJN"), Exh. A at pp. 44–64[8] [Opening Brief in *California Chamber of*

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[7] Article XIII A, section 3, subdivision (c) provides limited retroactivity as to the State. Article XIII C, section 1, subdivision (e) provides no similar language as to local government — suggesting no retroactivity as to local government was intended.

[8] Citations to the MJN exhibits are to Bates-stamped pagination, not original document pagination (e.g., MJN00044–MJN00064).

Commerce v. California Air Resources Board, Third District Court of Appeal Case No. C075930]; see also MJN, Exh. B at pp. 132–137 [Appellant's Opening Brief in *Morning Star Packing Co. v. California Air Resources Control Board*, Third District Court of Appeal Case No. C075954.)

- California's gun registration fees under Penal Code section 28225 are challenged as exceeding the cost of regulation under art. XIII A, § 3, subd. (b)(3). (MJN, Exh. C, at p. 155 [2nd Amended Complaint in *Bauer v. Harris*, E.D. Cal. Case No. 11 CV 01440].)

Thus, guidance on the scope of Proposition 26 will assist resolution of important questions pending in lower courts, secure uniformity of decisions among the appellate courts, and save myriad governments fees to litigate these and the cases predicted by the Dissent's footnote one.

Application of Proposition 26 to legislatively-imposed costs that predate it would prohibit using rate revenue to fund:

- programs to reduce greenhouse gases under 2006's A.B. 32 (Health & Saf. Code §§ 38550–38551);
- "green" power development (Pub. Util. Code § 387.5);
- solar energy mandates (Pub. Resources Code §§ 25780 et seq.);

- renewable energy mandates (Pub. Util. Code § 399.11); and,
- discounted rates for the poor and elderly.

(IV AR Tab 142, p. 817; IV AR Tab 145, p. 830; IV AR Tab 148, pp. 869–870.)

In short, any government agency that has legislatively mandated costs to achieve public policy goals beyond the cost of generating, transmitting, storing and distributing power — or the comparable costs of other government services — needs guidance whether that legislation survived Proposition 26. Thus Proposition 26's retroactivity is of wide-spread and immediate importance and affects dozens of laws of pressing social and environmental import.

B. Guidance Is Needed on the "Reasonable Costs" Standard of Articles XIII A and XIII C and the "Proportionate Cost" Standard of Article XIII D

Article XIII A, section 3, subdivision (b)(2) and article XIII C, section 1, subdivision (e)(2) refer identically to "reasonable costs" of services. However, there is yet no case interpreting that Proposition 26 standard. Proposition 218 imposes an analogous burden on property related fees via article XIII D, section 6, subdivisions (b)(1) and (b)(3).

Proposition 26's "reasonable cost" requirement could be the Proposition 13 standard applied in *Sinclair Paint Co. v. Board of*

Equalization (1997) 15 Cal.4th 866. That case and its progeny recognize that the distinction between a regulatory fee and a special tax turns on whether a payor's charge bears a fair and reasonable relationship to that payor's burdens on or benefits from the regulated activity. (*Id.* at p. 878, citing *San Diego Gas & Electric Co. v. San Diego County Air Pollution Control Dist.* (1988) 203 Cal.App.3d 1132, 1145–1146.) The few cases interpreting Proposition 26 to date have noted that its article XIII A, section 3, subdivision (d) and final, unnumbered paragraph of article XIII C, section 1, subdivision (e) are paraphrases of *Sinclair Paint*. (See, e.g. *Schmeer v. County of Los Angeles* (2013) 213 Cal.App.4th 1310, 1326 [citing *Sinclair Paint* to construe Proposition 26].) However, Proposition 26 was a reaction to *Sinclair Paint* and intended to alter its rule in some respects. (*Id.* at p. 1322; see also 1 CT 276 [legislative analyst's summary of Prop. 26].)

Thus, if the *Sinclair Paint* reasonableness standard applies under Proposition 26, as *Schmeer, supra,* Cal.App.4th 1310 suggests — and Justice Duarte would hold here — charging Redding's electric utility for general governmental services via a PILOT measured by the property tax investor-owned utilities pay is "fair and reasonable," and the PILOT is a lawful cost of service. (Dissent at pp. 4–5.)

What constitutes adequate record evidence showing rates do not exceed the proportional cost of services as demanded by

Proposition 218 (art. XIII D, § 6, subd. (b)(3)) confounds rate makers and courts. Because Proposition 26 was intended to build upon Proposition 218 (*Schmeer, supra,* 213 Cal.App.4th at p. 1322), the two are in pari materia and decision here will assist resolution of Proposition 218, too.

Proposition 218 disputes abound as well, and include:

- *City of Palmdale v. Palmdale Water Dist.* (2011) 198 Cal.App.4th 926 [insufficient record to show tiered retail water rates reflect proportional cost of service];
- *Capistrano Taxpayers Assn. v. City of San Jan Capistrano* [4th DCA No. G048969, testing same issue] (MJN, Exh. D at p. 163 (Appellant's Opening Brief));
- *Glendale Coalition for Better Government v. City of Glendale* [L.A. Super. Ct. No. BS153253, testing same issue] (MJN, Exh. E at p. 252 (Complaint));
- *Sweetwater Authority Ratepayers Association, Inc. v. Sweetwater Authority* [San Diego Super. Ct. No. 37-2014-00029611-CM-MC-CTL, testing same issue] (MJN, Exh. F at p. 280 (Complaint));
- *City of San Buenaventura v. United Water Conservation District* [2d DCA No. B251810, testing the same issue as to groundwater augmentation charges] (MJN, Exh. G at p. 302 (Respondent's Brief));

- *Great Oaks Water Co. v. Santa Clara Valley Water District* [Sixth Appellate District Case No. H035885, same] (MJN, Exh. H at p. 452 (Amicus Brief));

Capistrano, Ventura, and *Great Oaks* were submitted by separate panels of the 2nd, 4th and 6th District Courts of Appeal since December.

Further, a very recent decision construes Article XIII C, section 2's requirement for voter approval of "taxes" as applied to a city's franchise fee on a private power utility. *Jacks, supra,* ___ Cal.App.4th ___. It is significant here for a further reason — it expressly criticizes and declines to follow the Opinion as to Proposition 218's application to charges associated with electric service. (*Id.*, Slip Op. at 5 & fn. 4.)

These four Proposition 218 cases — *Capistrano, Ventura, Great Oaks,* and *Jacks* — will all be decided within a few weeks and it seems unlikely these decisions can inform one another. This creates a risk of confusing, uncoordinated decisions. Thus, review here can inform developments under Proposition 218, too, to the extent Articles XIII C and XIII D impose similar cost-of-service requirements.

C. Guidance Is Needed as to When Revenue Measures Are "Imposed" so as to Trigger Propositions 218 and 26

Propositions 218 and 26 apply to revenue measures "imposed" by government. (Cal. Const., art. XIII C, § 2 and