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Legal Notes

Are Utility Fees Subject to Proposition 218?

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On March 23, 2005, the Fifth District Court of Appeal decided *Howard Jarvis Taxpayers Association v. City of Fresno***. The court concluded that:**

- **Ordinary water, sewer and trash fees are subject to Proposition 218;**
- **Prop. 218's requirements have applied to such fees since July 1, 1997, whether or not such fees have been "extended, imposed or increased" since that time; and**
- **Utility fees may include the cost of providing municipal services to public utilities, such as the cost of repairing streets impacted by wear and tear of utility vehicle traffic.**

The *Fresno* **decision is not yet final and the city will appeal the decision to the California Supreme Court, which is considering similar legal issues in** *Bighorn-Desert View Water Agency v. Beringson.* **However, if the opinion becomes final and the California Supreme Court does not conclude differently in** *Bighorn***, it**

will mark a major shift in the law applicable to public utility rates. Whether or not the decision becomes final, it provides an occasion to review contested issues regarding utility rates under Prop. 218. It will be of greatest interest to agencies that transfer funds from utility enterprise accounts to general funds for purposes other than to recover the cost of services provided.

The Court of Appeal Decision

In 1957, Fresno voters amended the city's charter to authorize an ordinance requiring the city's utilities to make a payment in lieu of taxes (PILOT) to the city's general fund in the amount each would pay in property taxes if it were a private enterprise. The fee now amounts to 4.5 percent of the city's general fund, supporting police, fire, parks, public works and other municipal services for city residents. In 2003, the Howard Jarvis Taxpayers Association filed suit alleging the city's application of the PILOT to water, sewer and refuse services violates Prop. 218.

The city argued that its utility rates were not subject to Prop. 218 because they are not imposed due to property ownership alone, but rather voluntary decisions to consume utility services, citing a 2001 decision of the California Supreme Court involving housing inspection fees imposed by the City of Los Angeles. The city also asserted that the fees are not subject to Article XIII D, section 6(b) of the California Constitution (a provision of Prop. 218) because they have not been "extended, imposed or increased" since the November 1996 adoption of Prop. 218, as the measure's language requires. Finally, the city noted that the

PILOT operates much like a utility user's tax and received the appropriate voter approval required for such taxes.

Citing a decision involving the City of Roseville, the Fresno Superior Court rejected the city's contentions and ordered it to suspend imposition of the PILOT on water, sewer and trash services. On March 23, 2005, the Fifth District Court of Appeal affirmed this judgment.

The decision states that many utility charges for water, sewer and solid waste services are property-related fees subject to Prop. 218, concluding that "a fee for ongoing water service through an existing connection" is a property-related fee subject to Prop. 218 and that similar charges for ongoing sewer and solid waste services are also subject to that measure.

Next, the court concluded that Article XIII D, section 6(b), which imposes five substantive requirements when fees subject to Prop. 218 are "extended, imposed or increased," applies to Fresno's water, sewer and trash rates, even though those rates had not been "extended, imposed or increased." So if a fee is subject to Prop. 218 at all, this court concludes it must comply with Article XIII D, section 6(b), whether or not it has been "extended, imposed or increased" because the measure was adopted by virtue of section 6(d).

The court also concluded, however, that Fresno can require its utilities to reimburse its general fund for the direct and indirect costs of city services to those utilities, provided that it carefully calculates the cost of those services. Thus, if a city can calculate the wear and tear of utility vehicles on streets, the

cost of providing police and fire protection to utility property, and the cost of other municipal services to utilities, it can require the utilities to reimburse those costs to its general fund.

The opinion strongly suggests that the California Supreme Court's decision in Hansen v. City of San Buenaventura is no longer good law, at least as applied to water, sewer and solid waste services.

Hansen found that local governments were entitled to operate water and other utilities at a profit, with the excess revenues going to their general funds.

Finally, the court found that Fresno's PILOT was not a general utility user's tax and therefore the voter approval was irrelevant.

The City of Fresno has directed its counsel to seek rehearing of the case in the court of appeal and to seek review in the California Supreme Court, if necessary. The city's mayor and a 5-2 majority of its city council viewed the case as having very significant impacts on its ability to fund public services. The city's leaders voted to further appeal the case in the hope of attaining a statewide resolution to these important issues.

As a result, this decision is not yet final. It nonetheless identifies the current position of taxpayer advocates and highlights the major open issues regarding the fee provisions of Prop. 218.

Options for Public Utilities

Although the Fresno case is very recent and its impact on public utility rates will become clearer over time, some preliminary observations may be made. Local governments operating public utilities appear to have at least these options:

· Take no action to change utility rate-making practice until the final outcome of this case is known. It will be prudent to confirm that the agency has an up-to-date claiming ordinance in place to limit liability for refunds in the event the law changes and requires a change in agency rates. Such an ordinance can limit refund liability to one year. Otherwise a three-year statute of limitations will apply. Promptly comply with the substantive requirements of Article XIII D, section 6(b) and the procedural requirements of section 6(a) when adopting a new utility fee subject to Prop. 218, increasing such a fee or extending a fee's sunset date or other stated period of effectiveness. This approach is not yet legally required but eliminates any risk that the law might change or that the agency's rate-setting will draw legal challenge under Prop. 218. Many agencies have already taken this approach as a precaution and need make no changes as a result of the Fresno ruling.

- **Analyze the cost of services the agency provides to its utilities, including such indirect costs as street maintenance and police and fire services, and require the utilities to reimburse the agency's general fund for those costs.**
- **Revise utility fee structures to distinguish fees imposed for "ongoing water [or sewer or trash] service through an existing connection [or to**

an established account]" and fees imposed for services provided to a "self-selected group of water [or sewer or trash] service applicants" such as turn-on and turn-off fees, fees for the installation of a new or larger meter, and regulatory and inspection fees.

The Opinion's Effect on Rate-Making Practices

A number of specific rate-making practices appear to invite more thought in light of the not-yet-final decision in the *Fresno* case. Discounted rates for seniors, the disabled and low-income persons for water, sewer and trash services would appear to be subject to Prop. 218. Such subsidies can be funded with general fund monies or private donations. In addition, voters may approve such subsidies as special taxes, if two-thirds approval is obtained. Because such rate structures are popular, electoral approval may be feasible for many agencies.

Many agencies impose rate structures that encourage conservation by providing rates that rise with consumption. These structures may be defensible even under Prop. 218 if an agency can show that a failure to encourage conservation will require the agency to obtain additional supplies that will be more costly than existing supplies.

Conclusion

The Fresno decision is not final yet and therefore not a binding expression of California law. If the decision does become binding, however, it will represent a major change in rate-making law. The full impact of such a change is not yet known and will turn on the Supreme Court's decision in Bighorn - which is not expected until early 2006 - and on Fresno's petitions for rehearing and review in this case. In the meantime, the foregoing commentary may provide cities some initial guidance.

Proposition 218 in a Nutshell

Proposition 218 requires voter approval for all taxes and for certain fees that are "property-related." Water, sewer and refuse collection fees that are property-related are exempt from the voter approval requirement. Defining what is and is not a property-related fee has been the subject of several court cases. Prop. 218 also sets forth the procedure that must be followed to impose assessments on real property for capital improvements such as streets, sidewalks and landscaping. For more information, visit www.cacities.org and type "Proposition 218" into the site search box.

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[1] 2005 Daily Journal DAR 3402, 2005 West Law 665253. Although the views expressed here should be attributed only to the author, he gratefully acknowledges the comments and suggestions provided by Betsy Strauss and

Daniel S. Hentschke.

[2] California Supreme Court Case No. S127535

[3] The City of Fresno's municipal utilities include the Water Division, Solid Waste Management Division, Parking Division, Golf Course Division, Sewer Maintenance Division, Waste Water Management Division, Transit Department and Airports Department. The decision affects only PILOT payments by the water, sewer and solid waste utilities.

[4] In 2005, it is estimated that $8.5 million in fees would be transferred to the city's general funds.

[5] Specifically, the plaintiffs contended that the three utilities fees violated Article XIII D, section 6(b)(1) of the California Constitution, which requires that utility revenues "not exceed the funds required to provide the property related service"; section 6(b)(2)'s requirement that utility revenues "not be used for any purpose other than" utility operations; and section 6(b)(5)'s requirement that utility revenues not be used for "general government services, including, but not limited, to police, fire, ambulance or library services."

[6] *Apartment Association of Los Angeles County, Inc. v. City of Los Angeles*, **24 Cal. 4th 830.**

[7] *Howard Jarvis Taxpayers Ass'n v. City of Roseville*, **97 Cal. App. 4th 637 (2002).**

[8] Article XIII D, section 6(d) states: "Effective July 1, 1997, all fees or charges shall comply with this section."

[9] 2005 Daily Journal DAR at 3404.

[10] 42 Cal. 3d 1171 (1986)

[11] A model of such an ordinance is available at www.cllaw.us/papers/claims.doc .

[12] *See* **Government Code Section 905 (exempting refund claims from Government Claims Act), Section 935 (authorizing local claiming requirements for otherwise exempt claims),** *Pasadena Hotel Development Venture v. City of Pasadena* **(1981) 119 Cal. App. 3d 412 (upholding such an ordinance).** *See also, Howard Jarvis Taxpayers Association v. City of La Habra*, **(2001) 25 Cal. 4th 809 (in absence of local claiming ordinance, three-year statute of C.C.P. Section 338(a) applies to tax and rate refund claims).**

[13] Under *Richmond v. Shasta Community Services District*, **32 Cal. 4th 409, 430 (2004), these latter charges are not subject to Prop. 218. Fees on new development triggered by that development, such as capacity and connection charges, are also exempt by virtue of Article XIII D, section 1(b) and the** *Richmond* **case.**

[14] *See, e.g., Brydon v. East Bay Mun. Util. Dist.* **(1994) 24 Cal. App. 4th 178 (upholding such fees).**

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