Fresno Court of Appeal Rules Water, Sewer and Trash Fees Subject to Proposition 218

by

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Introduction. On March 23, 2005 the Fifth District Court of Appeal, which sits in Fresno, published its opinion in *Howard Jarvis Taxpayers Association v. City of Fresno*, 2005 Daily Journal DAR 3402, 2005 West Law 665253, concluding that: (i) ordinary water, sewer, and trash service fees are subject to the requirements of Proposition 218; (ii) that the requirements of Proposition 218 have applied to such fees since July 1, 1997 whether or not such fees have been "extended, imposed, or increased" since that time; and (iii) that 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. Ordinary utility charges had previously been thought to be exempt from the majority-protest procedures required by Proposition 218 and the substantive rules of that measure which limit the ways in which fees may be calculated. The California Supreme Court's 2001 decision in *Apartment Association of Los Angeles County, Inc. v. City of Los Angeles*, 24 Cal.4th 830, had held that the property-related fee provisions of Proposition 218 apply only to fees triggered by property ownership alone and not by voluntary conduct of the property owner, such as entering the residential rental market or consuming utility services. Many public utilities also relied on the 2002 decision of the Los Angeles-based Second District Court of Appeal in *Howard Jarvis Taxpayers Association v. City of Los Angeles*, 85 Cal.App.4th 79, which held that metered water rates were not subject to Proposition 218.

The *Fresno* decision is not yet final and may be appealed to the California Supreme Court which is considering similar issues in the pending case of *Bighorn-Desert View Water Agency v. Beringson*, Case No. S127535. Accordingly, the *Fresno* decision does not yet reflect the law of California. However, if the case does become final in its current form, and the California Supreme Court does not pronounce different conclusions in *Bighorn*, the *Fresno* decision will mark a major shift in the law applicable to the rates charged by public agencies which provide utility services in California. The balance of this paper provides background on the *Fresno* decision, analyzes the decision itself, and provides some preliminary thoughts regarding utility rate-making practices under the rules announced in the case.

The Fresno Case. In 1957 the voters of Fresno approved an amendment to the City's charter authorizing the City Council to adopt an ordinance requiring each of the City's utilities to make a payment in lieu of taxes ("PILOT") to the City's General Fund in the amount the utilities would pay in property taxes if they were operated as private enterprises. The City Council did so in 1964 and the fee now amounts to a substantial portion of the City's General Fund which provides police, fire, parks, library and other municipal services to residents of the City. The Howard Jarvis Taxpayers Association, together with other, local taxpayer advocates (the petitioners are referred to collectively in this paper as "HJTA"), filed suit challenging the City's application of the PILOT to water, sewer, and refuse services as violating Proposition 218. Specifically, HJTA contended the three utilities fees violated Article XIII D, Section 6(b)(1),

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."

The City defended the case, arguing that: (i) its utility rates were not subject to Proposition 218 because they are not imposed due to property ownership alone, but are triggered by voluntary decisions to consume utility services, (ii) the fees are not subject to the requirements of Article XIII D, Section 6(b) because they have not been "extended, imposed, or increased" since the adoption of Proposition 218 in November 1996; and (iii) the PILOT operates much like a utility users tax, albeit one imposed at the wholesale level, and was authorized by Fresno's voters in 1957.

The Fresno Superior Court rejected the City's contentions, accepted those of HJTA, and ordered the City to suspend imposition of the PILOT on water, sewer, and trash services. On March 23, 2005, the Court of Appeal affirmed this judgment. The Court's ruling is significant in a number of respects.

First, the decision states that many utility charges for water, sewer and solid waste services are property-related fees subject to Proposition 218:

> Fresno contends fees are subject to the restrictions of Proposition 218 "only if the fee is imposed ***solely*** because a person owns property and not because of the particular use to which the property is put." (Emphasis in original.) Fresno contends the in lieu fee is "not imposed solely on the basis of property ownership. Rather, it is imposed on the use of utility services." Fresno bases its contentions on its analysis of *Richmond v. Shasta Community Services Dist.* (2004) 32 Cal.4th 409 (*Richmond*).
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> Fresno's analysis of *Richmond* could hardly be more misguided. *Richmond* expressly states: "A fee for ongoing water service through an existing connection is imposed 'as an incident of property ownership' because it requires nothing other than normal ownership and use of property." (*Richmond, supra,* 32 Cal.4th at p. 427.) Fresno proposes that we reject the court's discussion as dicta. Even if the court's conclusions technically constitute dicta, we will not reject dicta of the Supreme Court without a compelling reason, not present here. (See *California Coastal Com. v. Office of Admin. Law* (1989) 210 Cal.App.3d 758, 763.)"

2005 DAR at 3405. Thus, the Court concluded that "a fee for ongoing water service through an existing connection" is a property-related fee subject to Proposition 218 and that analogous charges for ongoing sewer and solid waste services are similarly subject to that measure.

Next, the Court concluded that the language of Article XIII D, Section 6(b), which imposes five substantive requirements on the calculation of the property-related fees subject to

Proposition 218 when they are "extended, imposed, or increased," apply to Fresno's water, sewer and trash rates, which had not been "extended, imposed, or increased" since the adoption of Proposition 218. The Court concluded the measure was intended to impose those five substantive rules on all existing property-related fees within its reach:

> Section 6, subdivision (b) requires that a city or agency that acts to extend, impose, or increase a fee after the effective date of Proposition 218 must comply with the requirements of subdivision (b)(1) through (b)(5). However, section 6, subdivision (d) clearly requires, in addition, that cities and other agencies conform existing fees to the requirements of subdivision (b)(1) through (b)(5) by the stated date of July 1, 1997.

Id. Thus, if a fee is subject to Proposition 218 at all, this Court concludes it has been required to comply with the rules of Article XIII D, Section 6(b) whether or not it has been "extended, imposed or increased" since that time under Section 6(d). That subdivision states: "Beginning July 1, 1997, all fees or charges shall comply with this section."

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:

> 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. (See *Jarvis v. Los Angeles, supra,* 85 Cal.App.4th at pp. 81-82; *Oneto v. City of Fresno, supra,* 136 Cal.App.3d at p. 464.)
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> Proposition 218 changed all that with its constitutional requirement that "[r]evenues derived from the fee or charge shall not exceed the funds required to provide the property related service." (See art. XIII D, § 6, subd. (b)(1); see also *Jarvis v. Roseville, supra,* 97 Cal.App.4th at p. 649.)
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> Cities are still entitled to recover all of their costs for utility services through user fees. (*Jarvis v. Roseville, supra,* 97 Cal.App.4th at p. 648.) 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." (Art. XIII D, § 6, subd. (b)(3).)
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> Together, subdivisions (b)(1) and (b)(3) of article XIII, section 6, make it necessary – if Fresno wishes to recover all of its utilities costs from user fees – that it reasonably determine (*Jarvis v. Roseville, supra,* 97 Cal.App.4th at p. 648) 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."

Thus, if Fresno and other utility operators 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 its utilities, it can require the utilities to reimburse those direct and indirect costs to the agency's General Fund.

This discussion strongly suggests that the California Supreme Court's decision in *Hansen v. City of San Buenaventura*, 42 Cal.3d 1171 (1986) is no longer good law, at least as applied to water, sewer, and solid waste services. That case ruled that local governments were entitled to operate water and other utilities at a profit, with the excess revenues inuring to the benefit of their general funds.

The Court also concluded that Fresno's PILOT was not a voter-approved general tax. *Id.* at 3405-06.

Options for Public Agencies That Provide Water, Sewer and Trash Service. Although the case is very recent and its impact on the law governing public utility rates will become clearer over time, we can make some preliminary observations. First, the case is not yet final and may be reviewed by the California Supreme Court. Moreover, the questions of whether and how Proposition 218 affects ordinary water rates are also pending in the *Bighorn* case, which is not likely to be decided by the California Supreme Court until early 2006. Accordingly, it may be prudent for public agencies that provide utility services to take no action in response to this case until the status of the case becomes final and until the California Supreme Court rules in *Bighorn*.

If action before then seems prudent, then local governments operating public utilities would seem to have at least these options: (i) promptly comply with the substantive requirements of Article XIII D, Section 6(b) for utility charges and comply with the procedural requirements of Article XIII D, Section 6(a) for any action to adopt a new utility fee subject to Proposition 218, to increase such a fee, or to extend a sunset date or other stated period of effectiveness for such a fee, (ii) initiate a analysis of the direct and indirect 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; (iii) provide these services via a private operator rather than the agency's own forces (as is common for solid waste services), because Proposition 218 does not apply to service fees charged by private utility operators; (iv) revise utility fee structures to carefully distinguish between fees imposed on account of "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 fees such as cross-connection and backflow prevention inspections. Under *Richmond v. Shasta Community Services District*, 32 Cal.4th 409, 430 (2004), these latter charges are not subject to Proposition

218. Of course, 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.

Details of 218 Compliance. Proposition 218's fee provisions have both procedural and substantive requirements. The procedural rules are triggered by the imposition of a new fee or an increase in an existing fee. Article XIII D, Section 6(a). A fee is increased if the standards of Government Code Section 53750(h) are met. That section states:

> (h)(1) "Increased," when applied to a tax, assessment, or property-related fee or charge, means a decision by an agency that does either of the following:
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> (A) Increases any applicable rate used to calculate the tax, assessment, fee or charge.
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> (B) Revises the methodology by which the tax, assessment, fee or charge is calculated, if that revision results in an increased amount being levied on any person or parcel.
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> (2) A tax, fee, or charge is not deemed to be "increased" by an agency action that does either or both of the following:
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> (A) Adjusts the amount of a tax or fee or charge in accordance with a schedule of adjustments, including a clearly defined formula for inflation adjustment that was adopted by the agency prior to November 6, 1996.
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> (B) Implements or collects a previously approved tax, or fee or charge, so long as the rate is not increased beyond the level previously approved by the agency, and the methodology previously approved by the agency is not revised so as to result in an increase in the amount being levied on any person or parcel.
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> (3) A tax, assessment, fee or charge is not deemed to be "increased" in the case in which the actual payments from a person or property are higher than would have resulted when the agency approved the tax, assessment, or fee or charge, if those higher payments are attributable to events other than an increased rate or revised methodology, such as a change in the density, intensity, or nature of the use of land."

The procedures required for water, sewer, and trash fees are stated in Article XIII D, Section 6(a). Such fees are exempt from the election requirement of Article XIII D, Section 6(c) for other property-related fees, such as the parcel-roll fee for storm water and water quality services at issue in *Howard Jarvis Taxpayers Association v. City of Salinas*, 98 Cal.App.4th 1351 (2002).[1] Briefly, Section 6(a) requires the agency proposing a new or increased fee within the scope of Proposition 218 to:

[1] Pending Assembly Constitutional Amendment 13 (Harman, R-Huntington Beach) would also exempt flood control and storm water quality fees from the election requirements of Article XIII D, Section 6(c).

> provide written notice by mail of the proposed fee or charge to the record owner of each identified parcel upon which the fee or charge is proposed for imposition, the amount of the fee or charge proposed to be imposed upon each, the basis upon which the amount of the proposed fee or charged was calculated, the reason for the fee or charge, together with the date, time and location of a public hearing on the proposed fee or charge."

Article XIII D, Section 6(a)(1). The mailed notice may be "included in any other mailing to the record owner that otherwise complies with [Proposition 218] …, including, but not limited to, the mailing of a bill for the collection of an assessment or a property-related fee or charge." Government Code Section 53750(i). Thus, such a notice might be accomplished by an insert in utility bills or via a newsletter mailed to all property owners.

Second, the agency must:

> conduct a public hearing upon the proposed fee or charge not less than 45 days after mailing the notice of the proposed fee or charge to the record owners of each identified parcel upon which the fee or charge is proposed for imposition. At the public hearing, the agency shall consider all protests against the proposed fee or charge. If written protests against the proposed fee or charge are presented by a majority of owners of the identified parcels, the agency shall not impose the fee or charge.

Article XIII D, Section 6(a)(2).

This is an old-fashioned, "silence equals consent" majority protest in which the agency is free to impose the utility fee unless an absolute majority of affected fee payors objects to the fee in writing. As majority participation is rare in contemporary political life, such protests can be expected to be rare. Accordingly, Proposition 218's procedural requirements for the utility fees to which it applies should cost most agencies only the expense, delay, and political pain of the hearing process.

The substantive requirements of Article XIII D, Section 6(b) for the fees to which Proposition 218 applies are a bit more complicated. Section 6(b) states:

> (b) Requirements for Existing, New or Increased Fees and Charges. A fee or charge shall not be extended, imposed, or increased by any agency unless it meets all of the following requirements:
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> (1) Revenues derived from the fee or charge shall not exceed the funds required to provide the property related service.
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> (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.

> (3) The amount of a fee or charge imposed upon any parcel or person as an incident of property ownership shall not exceed the proportional cost of the service attributable to the parcel.
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> (4) No fee or charge may be imposed for a service unless that service is actually used by, or immediately available to, the owner of the property in question. Fees or charges based on potential or future use of a service are not permitted. Standby charges, whether characterized as charges or assessments, shall be classified as assessments and shall not be imposed without compliance with Section 4.
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> (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. 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. 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.

For the water, sewer and trash fees that *Fresno* holds to be subject to Proposition 218, the first, second and fifth rules amount to one requirement: such fees may recover no more than the cost of utility services and general fund transfers from utility accounts are not permissible unless they are demonstrably tied to the cost the utility imposes on General Fund services, including indirect costs for municipal services such as street maintenance, police, fire, and other services.

Nor need the fourth rule detain us long. It requires that standby charges and similar charges on property owners who do not use a service for the benefit they gain from the availability of service on request, must be imposed as assessments. That, of course, entails the property-owner balloting procedure of Article XIII D, Section 4 for new or increased assessments. However, Article XIII D, Section 5 will "grandfather" existing standby charges for water and sewer infrastructure and operation costs (but not for such costs associated with solid waste service).

It is the third rule which raises the most questions. What does it mean to say that a property-related utility service fee "shall not exceed the proportional cost of the service attributable to the parcel"? An annotation of the measure circulated by the HJTA prior to the adoption of Proposition 218 states, with respect to Article XIII D, Section 6(b)(3): "Under the initiative, fees, just like assessments, must be proportional." This statement helps but little, however, as assessments are impose in proportion to the *benefit* a property derives from the services or facility for which an assessment is imposed (Article XIII D, Section 4(a)) while Section 6(b)(3) requires a property-related fee to be proportional to the *cost* of providing service. Following the election, HJTA augmented its annotation, stating: "Under the initiative, fees, just like assessments, must be proportional *to the actual use of the service*." (Emphasis added.) This language sheds no light on what the voters who adopted Proposition 218 intended because it was

not written until after the voters had acted. Still, it suggests that a frequent litigant under Proposition 218 believes that Section 6(b)(3) requires property-related utility fees to be "proportional" to use of the service, as most metered utility rates are. Still, no definition of "proportional" is provided.

Dictionary definitions don't provide much further assistance. "Proportional" is, of course, the adjectival form of "proportion," for which **Merriam-Webster's Online Dictionary** (www.m-w.com) provides five definitions, two of them potentially relevant here:

> 2 a : proper or equal share <each did her proportion of the work> b : QUOTA, PERCENTAGE
> 3 : the relation of one part to another or to the whole with respect to magnitude, quantity, or degree : RATIO."

As the third definition does not describe any limit on what proportion one customer's fee must bear to the sum of all fees or to any other customer's fee, it is the second definition to which we turn. That requires a fee to reflect "a proper or equal share." If the goal is a rational user fee system in which one rate payer is not required to subsidize another, "equal" is not likely to have been the voters' intent, because treating all users the same would benefit users who consume large amounts of utility services, or are otherwise relatively expensive to serve, at the expense of other customers who impose smaller costs on the utility. Thus, the definition appears to mean that each user must be required to pay only a "proper" percentage of the total cost of providing utility services. This, of course, is no guidance at all.

The Legislative Analyst's Impartial Analysis of Proposition 218 provided this guidance:

> No property owner's fee may be more than the cost to provide service to that property owner's land. … The measure's requirements would also expand local governments' administrative workload. For example, local governments would have to adjust many property-related fees, potentially (1) setting them on a block-by-block or parcel-by-parcel basis and (2) ending programs that allow low-income people to pay reduce property-related fees.

The "no" argument on the measure stated:

> The impartial Legislative Analyst's report shows how Proposition 218 could impede LifeLine support for the elderly and disabled. It prohibits seniors and disabled from receiving needed utility services unless they pay all costs themselves.

To this, the proponents' rebuttal argument stated: "'Lifeline' rates for the elderly and disabled for telephone, gas and electric services are NOT affected." This, of course, implies that such rates for water, sewer and trash services *are* affected.

The "block-by-block, parcel-by-parcel" analysis suggested by the Legislative Analyst would be extremely difficult, if not impractical, especially for the State's largest utilities. Moreover, the State Legislature has recently mandated the use of meters to measure water consumption and fees based on measured consumption are time-honored, common and broadly accepted by Californians. We doubt the Courts will conclude that the somewhat opaque language of Article XIII D, Section 6(b)(3) requires elimination of such fee structures. Rather, we expect the courts to apply existing rate-making law, which is very deferential to the rate-maker provided that the rates are fair and reasonable and do not recover more than the cost of the service for which the fees are imposed. These cases hold that water rates and other consumer charges must be reasonable and based on the cost of providing service. (*E.g. Rincon del Diablo Muni. Wat. Dist. v. San Diego Co. Wat. Auth*. (2004) 121 Cal. App. 4th 813 (rev. denied.); *Beaumont Investors v. Beaumont-Cherry Valley Water District* (1985) 165 Cal. App. 3d 227; *Carlton Santee Corp. v. Padre Dam Muni. Wat. Dist*. (1981) 120 Cal. App. 3d 14.) Thus, rate structures which distinguish between water meters of different sizes or which impose a minimum periodic account maintenance charge are likely justifiable under Proposition 218's standard as under previous law – they are lawful if they are both reasonable and based on the cost of providing service.

Specific Issues. A number of specific rate-making practices appear to be bear more thought in light of the *Fresno* decision. As to *discounted rates for seniors, the disabled and low income persons*, these would appear to be prohibited for service fees subject to Proposition 218, including water, sewer, and trash rates. Such subsidies can be funded with general fund monies or private donations. In addition, such subsidies can be approved by the voters as a special tax, provided that two-thirds approval is obtained. As such rate structures are popular, electoral approval may be feasible for many agencies.

Many agencies impose *rate structures which encourage conservation* by providing rates that rise with consumption. These structures may be defensible even under Proposition 218 if an agency can show that a failure to encourage consumption will require the agency to obtain additional water supplies and that such supplies will be more costly than existing supplies. Similar arguments can be made about existing sewer and solid waste infrastructure and operation costs. If Proposition 218 applies, however, that analysis will be required.

Agencies which rely on *transfers from water, sewer, and solid waste enterprise funds to General Funds* will, obviously, have to revisit those transfers if *Fresno* becomes the law. At least two options appear: discontinue the transfer or justify it with respect to the cost of municipal services to the utilities, such as road maintenance and police and fire services.

Conclusion. The decision in *Howard Jarvis Taxpayers Association v. City of Fresno* is not yet final and is therefore not yet a binding expression of California law. If it does become a binding precedent, however, it represents a major change in the law that governs rate-making by public agencies which provide water, sewer, and trash services. The full import of such a change is not yet known and will turn on the Supreme Court's decision in *Bighorn-Desert View Water*

Agency v. Beringson, which is not expected until early 2006. In the meantime, the foregoing commentary may provide some guidance. As always, we'll keep you posted!