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CURRENT DEVELOPMENTS UNDER PROPOSITIONS 13, 62 & 218

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 concluding that telephone service packages which provide a mix of local and long-distance calling for a flat rate 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 based on the length 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 have begun to argue that they are not taxable under local UUT ordinances which reference the FET.

Last May, 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 (and 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 have been filed in Los Angeles Superior Court raising these same issues. The same plaintiffs' counsel are involved in all these 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 have been 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, and plaintiffs filed notices of related cases. As a result, all these lawsuits have been assigned to Judge Anthony Mohr, a complex civil trial judge at the Central Civil West Courthouse.

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 claim for a tax refund 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. An amended complaint is expected and discovery is under way. The plaintiffs amended their complaint against the City of Los Angeles before its demurrer could be heard; the City renewed its demurrer, which had yet to be heard as this paper is written.

TracFone Litigation: TracFone Wireless, Inc. has 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 have 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. TracFone has filed an amended complaint against the City of Los Angeles, which has renewed its demurrer on this theory.

Plainly, the 106+ 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. 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: Verizon Wireless v. Los Angeles (2nd District Court of Appeal, Case No. B185373) 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 call details. After passage 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 tax, arguing that Los Angeles had "changed its methodology" for administering the tax and could not do so without a vote of the electorate under Prop. 218. Verizon prevailed in Los Angeles Superior Court and the case is now on appeal.[1] The appeal was heard on February 22, 2007 and a decision is therefore due by May 23rd.

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.

Proposition 62 / Class Action Case. *Oronoz v. County of Los Angeles* is a Proposition 62 challenge to the County's utility users tax, which was imposed without voter approval during the period before *Santa Clara County Local Transportation Authority v. Guardino*, 11 Cal.4th 220 (1995) when Proposition 62's requirement of voter-approval of general taxes was understood to be unenforceable. Its primary current interest is that the Los Angeles County Superior Court

[1] Verizon's Respondent's Brief in this case notes, but reserves, its claims under the FET theories discussed above.

certified a class in the case in the teeth of the *Woosley* line of cases cited above. On April 20, 2007 the 2nd District Court of Appeal issued an order to show cause why a writ not issue to reverse that ruling. Nonetheless the case is a cautionary tale and an occasion to remind readers of the need to adopt a local claiming ordinance that expressly bars class and representative claims.

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, which 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. 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) has 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

[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.

requires 2/3-voter approval. The measure has not yet been assigned to a committee as this paper is written.

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 is now being briefed. The case is captioned *City of Union City v. Bay Area Cellular Telephone*, 1st DCA Case No. A114956.

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 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. This opinion is now final, but the underlying dispute remains to be resolved. Three consolidated cases against Stockton are the subject of cross motions for summary judgment that were heard in mid-March but had not yet been decided when paper was written.

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, 2007 Daily Journal DAR 4702, 2007 WL 779511 (1st DCA, filed March 16, 2007; ordered published April 9, 2007; printed in DAR April 11, 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 occupied 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.

6. Utility Rates

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), 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*. These provisions have provoked more controversy and litigation than Proposition 218's assessment and tax provisions.

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 sent the case back 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 in *Bighorn*, 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. 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.

Although the *Bighorn* court never mentions *Apartment Ass'n of Los Angeles County, Inc. v. City of Los Angeles*, 24 Cal.4th 830 (2001) (housing inspection fee not subject to Prop. 218 because imposed on voluntary decision to enter rental market, not mere ownership of property), it expressly overrules *Howard Jarvis Taxpayers Ass'n v. City of Los Angeles*, 85 Cal.App.4th 79 (2001) (metered water rates not property related fees subject to Prop. 218). *Bighorn*, 39 Cal.4th at 217 n.5.

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 seems 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) addresses these issues and is discussed below.

Another development of interest to counsel for 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 District v. San Marcos Unified School District*, 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. Board 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.

7. Post-*Bighorn* Legislation

Assemblywoman Anna Caballero (D-Salinas), chair of the Assembly Local Government Committee and a former Mayor and Councilmember of Salinas, has 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 would: (i) authorize notice of 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 or to the address at which the service is to be provided, (ii) authorize notice of a fee collected via the property tax roll to be mailed to the property owner at the address on the assessor's roll, (iii) require notice to property owners 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, (v) allow an agency which provides billing services for another agency to provide notice of that other agency's fee adoptions and increases, (vi) establish a 120-day statute of limitations, modeled on Government Code § 66022 (applicable to challenges to water capacity charges) while preserving local authority to impose a claiming requirement under Government Code § 935. The Howard Jarvis Taxpayers Association informally expressed support for all but the statute of limitations proposal. The bill was approved by Assemblywoman Caballero's committee on a 5-2, party-line vote on April 26, 2007. The HJTA opposes the bill due to the statute of limitations provision. Many local governments and associations support the measure, including the Association of California Water Agencies and the California Special Districts Associations, which sponsored the bill, the California Association of Sanitary Agencies and the League of California Cities.

8. General Fund Transfers

As discussed under section 6 above, the *Bighorn* case, and the *Roseville* and *Fresno* cases, impose new limits on transfers from funds derived from government charges for water, sewer and government-provided trash collection services. Cost allocation plans and repayments with utility funds of loans from the general fund raise no issues under Props. 13 and 218. Transfers justified by costs imposed by utilities on general fund programs, such as streets and public safety, appear defensible under *Roseville* and *Fresno* cases cited above.

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 (gas and electric 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.

9. 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. Rancho Palos Verdes successfully adopted such a fee by a very narrow margin and opponents obtained sufficient signatures under the very low standard of Article XIII C, § 3 to place the matter on the November 2007 ballot for possible repeal. 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 Ass'n 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 a similar 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 defeated via an 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.

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 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 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 when the Legislature adjourned in August 2006.

10. 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 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.

A pending case involving a charge imposed on those who pump groundwater may shed further light on Prop. 218's application to regulatory fees. *Pajaro Valley Water Management Agency v. Amrhen*, 2006 WL 2065255 (6th District Court of Appeal, July 27, 2006), initially upheld the district's charge on groundwater users to fund capital facilities and supplemental water supplies to augment groundwater supplies and to redress saltwater intrusion into the fertile agricultural areas in Santa Cruz County north of Salinas and Watsonville. Water quality issues in this region got worldwide attention with the recent spinach scare involving *e. coli* bacteria. The Court's reasoning, however, was plainly inconsistent with the *Bighorn* decision handed down two days earlier and the Court granted the landowner's petition for rehearing in August. The case was argued on February 27th and a decision is therefore due by May 28, 2007.

The Pajaro Valley WMA fee can be distinguished from *Bighorn* because it does not involve the provision of domestic water through a pipe, but rather the regulation of groundwater pumping that is doing discernible environmental damage, and thus many public lawyers are of the view that the fee should survive rehearing in light of *Bighorn*.

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 2/3 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

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 programs to federal contractors in lieu of imposing regulatory fees on the federal government itself:

> "Accordingly, we conclude the SWRCB failed to sustain its burden to show the basis for determining the manner in which the costs were apportioned under California Code of Regulations, title 23, section 1066, so that charges allocated to a payor bore a fair or reasonable relationship to the payor's burdens on or benefits from the regulatory activity. … The SWRCB did not provide any evidence to show the allocation of the actual cost of Division services provided to the holders of riparian, pueblo and pre-1914 appropriative water rights which hold 38% of the water subject to water rights. Nor was there evidence of the actual cost of Division services provided to the [federal] Bureau [of Reclamation] which holds 22 percent of the water subject to water rights. Without any evidence to show the allocation of actual costs of Division services to those collectively representing 60 percent of water diverted, we reject the claim that the 'polluter pays' rationale justifies imposing annual fees on the license and permit holders who represent the remaining 40 percent. At the same time, however, we reject plaintiffs' argument there was an inequitable apportionment of fees among the designated annual fee payers. Although the SWRCB did not offer evidence of the actual cost of billing the annual fees, we cannot say a $100 minimum annual fee was an unreasonable estimate of that cost."

Id., 53 Cal.Rptr.3d 445, 465-66 (citations and internal quotations omitted).

The California Supreme Court has granted review of the case, which means the appellate decision is not longer citable authority. However, the Supreme Court's grant of review of the case, together with the pending decision in the *Pajaro Valley* case, indicate that this is a fertile time in the law of regulatory fees. Guidance as to Proposition 13's and 218's limits on the freedom of a regulatory agency to spread the cost of its programs via fees seems to be in the offing. Decision in the *Farm Bureau* case is not likely until 2008.

11. 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 first case to test this question (filed by a retired City Attorney of Beverly Hills) was *BadTax v. Mountains Recreation and Conservation Authority*. In that 2003 case, the Los Angeles Superior Court ruled for MRCA and the plaintiffs abandoned their appeal.

The pending Supreme Court case, 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 the unspecified 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 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 late this year. 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.

12. 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 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.

13. Assessment Litigation Procedures

A helpful new decision is *Bonander v. Town of Tiburon*, 147 Cal.App.4th 1116 (1st DCA, January 31, 2007), which 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. The case is 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 court rejected a claim that the adoption of Proposition 218 relaxed these requirements. A petition for review in the California Supreme Court was filed April 2, 2007 and remains pending as this paper is written.

14. 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?

The *Bighorn* case discussed above resolves some of these questions, but leaves others to be decided by future cases. The Court 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.

Curiously, the Court held that the initiative provision of Proposition 218 is limited to measures to "reduce or repeal" revenue measures, because this is the language of the first sentence of Section 3 of Article XIIIC. *Id*. However, this construction ignores the second sentence of that section, which refers to the power of initiatives to "*affect* local taxes, assessments, fees and charges." Moreover, federal cases involving the rule of equal protection in the context of ballot access requirements may well raise substantial problems for an interpretation which allows initiative tax reduction measures, but not tax increase measures. This question, too, remains open.

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 extend to making 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 public utilities 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.

Conclusion

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