Colantuono & Levin, PC
11406 Pleasant Valley Road
Penn Valley, CA 95946-9024
Main: (530) 432-7357
FAX: (530) 432-7356
WWW.CLLAW.US

Michael G. Colantuono
MColantuono@CLLAW.US
(530) 432-7359

League of California Cities Annual Conference
San Diego, California
September 17, 2010

(Updated through August 28, 2010)

CURRENT DEVELOPMENTS UNDER PROPOSITIONS 13, 62 AND 218

1. Class Action Challenges to Taxes

In *County of LA v. Superior Court (Oronoz),* 159 Cal.App.4th 353 (2008), the Los Angeles Court of Appeal considered a challenge to LA County's utility users tax (UUT) under Prop. 62. LA County adopted its tax in 1991, when Prop. 62's requirement of voter approval of local general taxes was unenforceable. The *Guardino* decision upheld Prop. 62 in 1995 and, apparently, LA County never sought voter approval of its tax even though the California Supreme Court made it clear in both *Guardino* and the 2001 *HJTA v. La Habra* case that compliance was required. Perhaps because of these bad facts, the Court of Appeal decided an issue the *Oronoz* parties had not briefed and opened the door to class actions against local taxes, an ominous development for local government given the entire industry of talented lawyers who seek class-action opportunities because of the lucrative ⅓-share of the return often awarded lawyers in such cases.[1]

The trial court in *Oronoz* certified a plaintiff class challenging the County's UUT. Both the plaintiff class and the County argued on a writ to the Court of Appeal that the County's local claiming ordinance applied, but disagreed whether that ordinance permitted class claims. The Court of Appeal, disagreeing with a large number of published appellate decisions, including *Batt v. San Francisco,* 155 Cal.App.4th 55 (2007), found that local claiming ordinances do not apply to tax claims to which no state statute other than the Gov't Claims Act applies, stripping local governments of the power to impose claiming requirements on many tax and fee challenges. The Court also found, contrary to precedent, that class claims against local taxes

[1] Los Angeles County proposed a ballot measure to reduce the utility tax from 5 to 4.5% and it was approved in November 2008. The county then settled the case for $172 million. In August 2009, the **Los Angeles Times** reported a new suit had been filed alleging the ballot materials regarding the November 2008 measure were misleading.

were permissible provided such claims "substantially" comply with statutory claiming requirements.

In *Ardon v City of Los Angeles*, Cal. S. Ct. Case No. S174507, the Second District Court of Appeal reversed its own *Oronoz* decision and held that class claims are not permitted in local tax refund cases. The Court recognized the need for fiscal predictability and strict legislative control over refund claims at the local as well as state level and held that constitutional protections apply to general as well as specific claiming statutes, including the Government Claims Act, thus barring tax refund claims asserted against local agencies. The ruling was remarkable both for its significance to the fiscal stability of local governments and because two of the three justices were on the panel that had reached the contrary result in *Oronoz* and the panel expressly overruled *Oronoz* by a two-to-one vote. Although the Court found Los Angeles had no local claiming ordinance applicable to the telephone users tax refund claim at issue – and therefore did not rule as to whether a local claiming ordinance could apply to a local tax refund case – it concluded that the claiming requirements of the state Government Claims Act do not allow class claims against local agencies for refunds of local taxes.

The Court explained that the constitutional limitation of Article XIII, § 32 which limits tax refund claims to procedures specified by the Legislature:

> rests on the premise that strict legislative control over the manner in which tax refunds may be sought is necessary so that governmental entities may engage in fiscal planning based on expected tax revenues. . . . [A]rticle XIII, section 32 serves the important purpose of prohibiting an unplanned disruption of revenue collection, "so that essential public services dependent on the funds are not unnecessarily interrupted."
>
> This policy is especially important where, as here, a plaintiff seeks to assert a class action on behalf of very large numbers of people, and the governmental entity faces an unexpected and huge liability. It is vital that the Legislature retain control over the manner in which claims may be asserted, so that governmental entities have sufficient notice of claims to allow for predictable and reliable fiscal planning.

One of the two justices who served on both the *Oronoz* and *Ardon* panels wrote a concurrence to explain her change of position and to invite the California Supreme Court to decide the issue. The other dissented, holding to his views in *Oronoz*. Unsurprisingly, the

California Supreme Court granted review. The case is now fully briefed and awaiting argument in that court.[2]

Another pending case involving the protections of Article XIII, § 32 and this same panel of the Court of Appeal is *Loeffler v. Target Corporation*, Cal. S. Ct. Case No. S173972, which concluded that § 32 prohibits a consumer from compelling Target to refund sales taxes collected on sales of hot coffee. The Court concluded that the Constitution requires strict compliance with statutory procedures to obtain refunds of sales taxes and those procedures do not allow a refund claim by a consumer, but require the refund to be sought by the retailer. The Court also rejected efforts to sidestep this bar by suing for consumer and common law remedies: "We reject plaintiffs' argument and find that a court may not *directly or indirectly* enjoin or prevent the collection of a sales tax." The California Supreme Court granted review of the case and the case has been fully briefed and awaiting argument since May 2010. Target's counsel is former 2nd District Court of Appeal Justice Miriam Vogel.

2. Utility Users Taxes

Local Claiming Requirements: Sellers of prepaid telephone calling cards including Tracfone Wireless, Inc. and Sprint / Nextel Boost have challenged the application to their services of UUTs which reference the FET. Tracfone sued the County of Los Angeles. 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.

The Court of Appeal reversed, concluding Tracfone did have standing to seek a refund. *Tracfone Wireless, Inc. v. County of Los Angeles*, 163 Cal.App.4th 1359 (2008). The Court conclude that Tracfone's payments could not be viewed as voluntary, accepting its argument that it had no administrative means to collect taxes from consumers who bought its calling cards and phones throughout the country (ignoring the likelihood that market forces might include such taxes in the sales prices of phones and cards) and that Tracfone was required by the County's ordinances to pay the tax before contesting it. The Court of Appeal remanded the case to try the factual claims, including whether Tracfone in fact paid the tax or was able to pass it through to its customers. The Court found it unnecessary to reach Tracfone's constitutional argument that due process required that it have the right to sue and the right to a refund, finding these mooted by its ruling on standing.

As was the case in *Ardon*, however, in argument of *TracFone v. City of Los Angeles,* Second District Court of Appeal Case No. B207288*,* to the same division of the Second District that decided *Oronoz* and *Ardon,* advocates for the City of Los Angeles[3] were again able to

[2] *Borst v. City of El Paso de Robles*, San Luis Obispo Superior Court Case No. VC 09-8117, filed July 28, 2009, also involves the availability of a class remedy, in this case in a challenge to Paso Robles' water rates. As this paper is written, the case is stayed pending decision of *Ardon*.
[3] Sandra Levin of Colantuono & Levin argued *TracFone* for Los Angeles.

persuade the Court to reconsider its position. On June 22, 2009, following argument, the Court issued an order soliciting additional briefing from the parties and amici (such as local government associations and taxpayer advocates) on whether Los Angeles' ordinance governing tax refund claims is preempted by the Government Claims Act and, more broadly, whether local claiming requirements for tax and fee refunds are permitted by the Government Claims Act. On March 29, 2010, however, the Court issued an unpublished decision for TracFone, concluding that TracFone had standing under the County case cited above and that the City ordinance which required TracFone to have refunded the tax to customers before it could seek a refund did not actually apply because TracFone alleged it paid the tax and therefore need not be required to refund it. The Court noted that the City's interpretation might violate due process by denying TracFone any remedy if it proved the illegality of a tax it alleged it had voluntarily paid for its customers. The California Supreme Court denied a request for publication of the case and it is now pending in the trial court on remand.

Legislation Affecting Telephone Taxes: Assemblyman De La Torre (D-South Gate) introduced AB 910 in 2009 to subject prepaid calling cards to the State's Emergency Telephone Users Surcharge Act, which provides funds to police and fire agencies to operate the State's 911 system. The fee would be collected at sale and, under the language of the bill, other taxes and fees could not be collected from the carriers. After local governments objected that the bill would impair their ability to collect cell phone taxes, Assemblyman De La Torre cancelled the hearing on his bill and it died in January 2010.

February 19, 2010, Assemblyman De la Torre introduced AB 2545 to direct the California Public Utilities Commission to conduct hearings and development recommendations regarding "an equitable manner for mobile telephone service providers to collect the [911] surcharge from users of prepaid communication services [*i.e.,* calling cards]." While the goal of the bill – to simplify and ensure collection of the State's 911 fee from pre-paid calling cards (a growing part of the cellular market), local governments fear the industry will use the measure to assert state control over implementation of local UUTs on calling cards, as well. This measure is pending adoption on the Senate floor as this paper is written.

Congresswoman Zoe Lofgren's (D-San Jose) H.R. 1521 is the so-called "Cell Tax Fairness Act of 2009." Sponsored by the wireless industry, it would prohibit, for five years after adoption of the bill, any new tax on cellular telephony which exceeds the lowest of the sales tax rate, the business license tax rate, and the tax on commercial property. Given Prop. 13's limit on property taxes to 1%, this would require new cell taxes to be limited to 1%, imperiling taxes on which California localities depend for millions of dollars for essential services. California sponsors of the bill as of August 21, 2010 include representatives Baca, Bilbray, Bono Mack, Calvert, Capps, Cardoza, Costa, Eshoo, Herger, Hunter, Issa, Lungren, Matsui, McCarthy, McNerney, Miller, Radanovich, Richardson, Rohrabacher, Roybal-Allard, Royce, Loretta Sanchez, and Speier. The bill was assigned to the House Judiciary Committee and its Subcommittee on Commercial and Administrative Law, which held a hearing on the bill on June

9, 2009. Agencies with local cell phone taxes may wish to communicate their concerns to California members of this subcommittee: Representatives Berman, Gallegly, Issa, Lofgren, Lungren, Linda Sanchez, Sherman, and Waters or to the representatives who have co-sponsored the measure. As of August 21, 2010, the bill had 194 co-sponsors.

The Senate version of this bill is S. 1192 introduced by Senator Wyden (D-Oregon) and, as of August 21, 2010, has 8 sponsors. Neither Senator Boxer nor Senator Feinstein has co-sponsored the bill or serves on the Senate Finance Committee, to which it has been referred.

Sample letters of opposition to both bills are available from the League of California Cities.

3. 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 implemented similar fees and litigation ensued. The central legal issues were 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.[4]

In *Bay Area Cellular Tel. Co. v. City of Union City* 162 Cal.App.4th 686 (2008), the San Francisco Court of Appeal invalidated Union City's 911 Fee as a tax requiring voter approval under Props. 62 and 218. The fee was imposed on all who purchased phone service in the City, as a flat fee per month per line, to fund the cost to equip and staff the City's 911 emergency dispatch service. The City argued the fee was imposed only on those who had access to the 911 service and was therefore a fee for service rather than a tax. The Court concluded it was a tax because 911 service is open to everyone present in the City when an emergency occurs. The Court also concluded that a fee for mere access to a government service could too easily allow the imposition of fees for access to every service government offers, such as a fee for access to city hall, to streets, to police and fire services, etc. The California Supreme Court denied review and the case is now final.

Ventura opened a new line of thinking with respect to 911 fees, adopting a fee which allows telephone users in the City to pay the fee via a monthly charge on phone bills or to opt-out and pay the fee on a per-call basis if and when they use the 911 service. The City argued that this makes the fee essentially voluntary and demonstrates that the fee is only paid by those who use the service. However, the ordinance drew a lawsuit and the City settled, repealing the fee. A

[4] After the Bay Area Cellular decision, San Francisco's Board of Supervisors placed a measure on the November 2008 ballot which voters approved to eliminate the 911 Fee and replace it with a special tax.

few other agencies have expressed interest in Ventura's approach and the *Bay Area Cellular* case may not be the last word on the subject.

4. Property Taxes

Property Tax Administration Fees: In recent years, the Legislature has used its power to allocate property taxes among local governments to reduce its obligation under Proposition 98 to fund K-12 schools. The VLF Swap replaced local revenues derived from vehicle license fees (reduced by the Legislature following Governor Schwarzenegger's election in the recall of Gray Davis in 2003) with additional property taxes. In 2004, the Legislature reduced local sales taxes, replacing these with property taxes as well, in a maneuver labeled "The Triple Flip." The Legislature adopted Revenue & Taxation Code § 97.75 to govern counties' ability to recover the cost to administer these devices from the cities that benefit from them. That measure provided that counties could not recover these costs in FY 2004-05 and FY 2005-06 but that they could recover their "actual costs" in future years. Although these costs are relatively small (Los Angeles County stipulated that its costs were just $35,000) many counties, relying on informal Guidelines prepared by the County Auditors' Association, redistributed the entire cost to collect property taxes – including assessments, assessment appeals, Sheriff's sales, etc. – among local governments to account for these new revenues. The result was an estimated $40m per year increase in amounts charged to California's cities by counties.

City of Alhambra and 46 Other Cities v. County of Los Angeles, 186 Cal.App.4th 537 (2010) [5] overturned a trial court ruling for the County and concluded that Rev. & Tax Code § 97.75 allowed counties to recover only the actual cost of implementing the VLF Swap and Triple Flip and did not permit them to increase cities obligation for the general cost of administering the property tax system in proportion to these property taxes paid in lieu of sales taxes and VLF. A petition for review in the California Supreme Court is pending as this paper is written.

The Fresno County Superior Court reached the same result in *City of Clovis et al. v. County of Fresno*, 5th DCA Case No. F060148, and the County appealed to the 5th District Court of Appeals in Fresno. As this paper is written, the opening brief had yet to be filed in that case.

No- and Low-Property-Tax City Subventions: Scotts Valley won a $2m judgment against the County of Santa Cruz for misallocating the no- and low-property-tax subvention required by the Tea Equity Allocation (TEA) statute, Rev & Tax Code § 98, by charging against the City's TEA subvention funds never received by the City due to ERAF shifts and tax increment paid to its redevelopment agency. The case is now on appeal to the First District Court of Appeal as

[5] The author of this paper and Holly Whatley of Colantuono & Levin are counsel for the petitioner cities in the Los Angeles County case.

case number A126357 and is fully briefed and awaiting argument as this paper is written. Other no- and low-property tax cities may wish to monitor the case.[6]

Property Tax Litigation Procedures: *Steinhart v. County of Los Angeles*, 47 Cal.4th 1298 (2010) is principally a discussion of whether the death of the trustor of a revocable trust is a change of ownership that triggers reassessment under Prop. 13. It has two aspects of interest to local government tax cases. First, it helpfully rejects three defenses to the duty to exhaust administrative remedies (no duty to exhaust on legal issues, futility, and estoppel from an ambiguous notice of appeal rights). Second, it helpfully defers to statutory constructions of Prop. 13 and will therefore help local government advocates defend reliance on the 218 Omnibus Implementation Act of 1997.

[6] The author of this paper and Holly O. Whatley of Colantuono & Levin authored an amicus brief in support of Scotts Valley on behalf of the League of California Cities in the case

5. Parcel Taxes

Sacks v. City of Oakland is a dispute regarding the interaction of a voter-approved special parcel tax (Measure Y) to "[h]ire and maintain … 63 police officers" assigned to community policing positions and the department's labor MOU which forbade placing new hires in non-patrol assignments. The City used the funds to hire new patrol officers, reassigning more senior officers to the community policing positions. The Alameda County Superior Court found: "The City may not lawfully use Measure Y funds for any aspect of hiring or maintaining any recruit hired into the Police Department to fill any other positions; including recruits that may, someday be assigned to a Measure Y position. The City's appeal to the First District Court of Appeal is fully briefed as Case No. A126817 and, as this paper is written, has been placed on the Court's conference calendar, indicating it will be soon set for argument.

Borikas v. Alameda Unified School District, 1st DCA Case No. A129295, involves a broad-brush challenge to a 4-year parcel tax approved by voters of the Alameda USD with the barest margin over the required ⅔ vote at the June 3, 2008 election. Among the issues raised by the case are: (i) was the tax levy based on parcel size and use "uniform" as the California Constitution requires property taxes to be? (ii) may a "special" parcel tax fund general expenses of a school district? (iii) is the tax unlawfully ad valorem due to its allocation based on parcel size and use? and (iv) does its limitation of the senior citizen exemption to residential property violate Education Code provisions authorizing the tax. These questions would seem to have obvious answers in favor of the school district and the trial court ruled for the City. The case is worth monitoring to see if it produces unexpected results. The appeal was filed August 8, 2010 and is in its earliest stages.

6. Hotel Bed Taxes

Batt v. City & County of San Francisco, 155 Cal.App.4th 65 (2007), was a class action challenging application of the City's hotel bed tax to hotel parking charges, claiming the City's ordinance applied only to room rents. The trial court sustained the City's demurrer to the class claim, citing the claiming requirement of the City's bed tax ordinance which expressly prohibited class claims. The Court of Appeal affirmed, citing *Woosley v. State of California*, 3 Cal.4th 758 (1992), for the proposition that class actions challenging public revenue measures require express statutory authority and the San Francisco claiming ordinance expressly disclaimed such authority. That issue, of course is pending before the California Supreme Court in *Ardon v. City of Los Angeles*, discussed in section 1 of this paper above.

Batt v. City & County of San Francisco, 184 Cal.App.4th 163 (2010) is the second published appellate decision in this dispute. It decides the named plaintiff's own claim for a refund and for declaratory and injunction relief to prevent continued collection of the bed tax on the parking portion of hotel bills. The plaintiff relied on the language of the City's tax ordinance, which imposed the bed tax on "the rent of every occupancy of a guest room in a hotel

in" San Francisco, and that a parking space is not a guest room and use of a parking space is not "occupancy" of a guest room. The City, however, relied on regulations adopted by the City's Tax Collector which specifically included parking charges in the fees to which the bed tax applied. The Tax Collector was authorized by the tax ordinance "to promulgate regulations and issue rules, determinations and interpretations consistent with [the tax ordinance] as may be necessary or appropriate for the purpose of carrying out and enforcing the payment, collection and remittance of taxes." Language like this is commonly included in tax ordinances.

Moreover, the City's tax ordinance defined the "occupancy" of a hotel room the rent for which was subject to tax to include "[t]he use or possession, or the right to use or possession of any room or apartment in a hotel or the right to the use or possession of the furnishings or to the services and accommodations accompanying the use and possession of the room." It was not a stretch for the trial and appellate courts to conclude that hotel parking paid via a hotel bill is a "service or accommodation accompanying use" of a hotel room.

What makes the case of interest to other local governments; however, are the rules of construction the court employed, which will be helpful in other disputes involving regulations, policies, and other administrative guidance to those subject to local government taxes and fees. First, tax collectors and other administrators have the power to "fill up the details" of a tax or fee ordinance and, so long as they act consistently with the ordinance itself, can address subjects which are not discussed in the ordinance at all. This power "includes the power to elaborate the meaning of key legislative terms." Second, such regulations are "presumed to be valid" and a challenger bears the burden to overcome that presumption.

Drafting such policies, of course, requires care and legal advice, however, because regulations can be viewed as exceeding the scope of the ordinance they construe, which might make them a new or separate tax requiring voter approval under Propositions 62 and 218. In addition, such regulations can clearly establish an agency's "administrative methodology" for implementing a tax or fee, which will require voter approval to make any change to that "methodology" that constitutes a tax or fee increased as Government Code § 53750(h) defines that term.

Collection of Bed Taxes on Hotel Rooms Sold By Internet Resellers. A class action on behalf of local governments is now pending against a number of internet resellers of hotel rooms. Separate cases have been consolidated for trial in Los Angeles Superior Court. Those companies purchase rooms from hotels at discounted rates, resell them at higher rates, and are subject to local bed taxes as sellers of hotel occupancies. Rather than collecting the tax and remitting it to local governments, however, the companies rely on the hotel to pay the tax on the wholesale cost of the room, often keeping the tax on the spread between the wholesale and retail rates as a "fee." Los Angeles, San Diego, Anaheim, West Hollywood and other cities filed class actions in Los Angeles and San Diego Superior Courts to challenge the practice and to recoup underpaid taxes.

In 2007, the trial court accepted the resellers' arguments that the local governments were required to exhaust their administrative remedies by auditing the resellers and conducting a hearing on the amount of taxes demanded. In 2008 it was reported that the internet sellers had failed to cooperate with the determination of taxes due, the cities then exercised their authority to calculate the tax owed based on information available to the cities and sent proposed tax liability determinations to the internet resellers. This prompted the resellers to negotiate and a hearing officer determined the on-line resellers' tax liability to Anaheim in lengthy decision submitted to the City in late January 2009. The matter returned to court and the trial court heard Anaheim's motion to deny a writ of mandate sought by the online resellers to set aside the hearing officer's determination on November 4, 2009. On February 1, 2010 the trial court ruled in favor of the resellers, concluding that the language of Anaheim's ordinance does not in fact subject the resellers to the tax. An appeal is likely after the trial court decision becomes final in summer 2010.

Agencies with substantial hotel occupancy receipts would do well to follow this litigation and to consider participating in it. The cases are *City of Los Angeles, et al. v. Hotels.com, L.P. et al*., Los Angeles County Superior Court Case No. BC 326693, *City of San Diego v. Hotels.com, L.P. et al*., San Diego County Superior Court Case No. GIC 861117, and the consolidated case number is JCCP 4472. Counsel for the local governments can provide more information about the case and the terms under which his firm will represent additional local governments: Paul Kiesel, Kiesel, Boucher & Larson, LLP, (310) 854-4444. More information about the case is posted to that firm's website at www.kbla.com.

San Antonio won a federal jury trial award of $20m from 11 online travel companies, including Expedia, Priceline, Travelocity and Orbitz, in a case brought on behalf of 173 Texas cities on this same issue, so the application of bed taxes to internet resellers is an nation-wide issue.[7]

Similarly, the City of San Diego was awarded $21.2 million by an administrative hearing officer in August 2010. That decision will undoubtedly be the subject of judicial review.8

A related matter is *Priceline.com, Inc. v. City of Anaheim*, 180 Cal.App.4th 1130 (2010), *review denied* March 24, 2010. In this case the on-line resellers challenged Anaheim's use of contingency-fee counsel in the underlying case, arguing that such arrangements violate due process by impairing governments' objectivity due to the profit motives of contingency counsel. The trial court upheld the use of contingent fee counsel and the on-line resellers appealed. The League of California Cities and the California State Association of Counties filed a joint *amicus* brief on behalf of Anaheim and the Fourth District in Santa Ana ruled for the City, finding the

[7] Guillermo Contreras, **San Antonio Express News**, "SA Wins Huge Suit Against Online Companies," posted October 31, 2009 to www.Mysanantonio.Com (viewed December 12, 2009).
8 Pat Broderick, **Los Angeles Daily Journal**, "Travel Websites Face Big Tax Verdict," Aug. 6, 2010.

case to be "ordinary civil litigation" to which the due process principles involved in the one prior appellate decision forbidding contingency counsel – a public nuisance case – did not apply.

County of Santa Clara v. Superior Court (Atlantic Richfield Co.) (2010) 50 Cal.4th 35 involved this question: "May a public agency retain private counsel to prosecute a public nuisance abatement action under a contingency fee agreement?" The case drew very broad interest – fully 16 *amicus* briefs have been filed, including a joint brief for the League of California Cities and the California State Association of Counties. Although the California Supreme Court required some revisions to the agreements between the local governments in the case and their contract, contingency counsel, the Court generally authorized the use of contingency counsel in nuisance cases provided that government counsel retains control over the case.

Another development in the internet hotel tax wars is *City of Oakland v. Hotels.com*, 572 F.2d 958 (9th Cir., 2009) which affirmed a US District Court decision requiring the City of Oakland to exhaust its own administrative procedures before suing internet hotel resellers for unpaid bed taxes. The City was required to determine the amount of tax due after affording due process to the taxpayers, demand payment, and then sue to enforce its determination. This is the same result the Los Angeles County Superior Court reached in the cases described above.

Given the huge dollar amounts at stake, the online resellers are also seeking legislative relief in both Sacramento and Washington and local government advocates are watching these developments closely.

SBX6 2 (Calderon, D-Montebello), introduced in the 6th Special Legislative Session in the 2009-10 Legislature, would exempt internet resellers from the usual duty to "pay first, litigate later" by paying a tax under protest and then filing suit to challenge it. It is proposed in the special session to make it immediately effectively without the ⅔ approval required for urgency legislation, but it is not clear the legislative leadership will allow it to proceed in that session. The "pay first, litigate later rule" is crucial to all taxing entities, because the absence of such a rule would grant hold-up leverage to each and every taxpayer and make local government finance depend on the litigation tactics of taxpayers. The bill was introduced November 24, 2009 and was assigned to the Senate Revenue & Taxation Committee on April 19, 2010. No action has been taken on the bill since.

This issue was decided adversely to Anaheim in *City of Anaheim v. Superior Court (Priceline.com, Inc.)* 179 Cal.App.4th 825 (2009). After the City determined a $21.3m deficiency against Priceline.com and other online resellers, Priceline filed suit seeking mandamus and declaratory relief without first paying the tax. The City demurred, citing the "pay first, litigate later" rule, and the trial refused to dismiss the suit. The City sought a writ (a means to obtain appellate review of trial court decisions which do not finally resolve a case and are therefore not yet subject to appeal), which the Los Angeles District Court of Appeal (hearing the

case due to consolidation of internet bed tax cases in Los Angeles) refused to hear. The California Supreme Court granted a petition for review and remanded the case to the appellate court for briefing and argument. Five days after argument, the Court of Appeal again rejected Anaheim's position, holding that Article XIII, § 32 of the California Constitution, which bars courts from interfering with the collection of taxes, does not apply to local governments and noting Anaheim had no local "pay first, litigate later" rule. The case is inconsistent with a long line of cases involving local government taxes and Anaheim is seeking further review by the California Supreme Court. In the meantime, local governments that impose taxes and fees are well advised to adopt local "pay first, litigate later" rules if they have not already done so. The California Supreme Court denied Anaheim's petition for review (over Justice Kennard's dissent) and this aspect of the case is now final.

In late April 2010, the League of California Cities also issue a notice to its members suggesting that Senator Roderick Wright (D-Los Angeles) might be open to gutting and amending SB 625 to address the industry's desire to avoid local taxation of internet resellers of hotel rooms. As of August 21, 2010, the bill remains in its original, non-TOT form.

In July 2009 the Multistate Tax Commission issued a draft "Model Statute on the Tax Collection Responsibilities of Accommodation Intermediaries" that would clarify the responsibility of resellers to collect hotel bed taxes.

7. Estate Taxes

Burkey v. State of California, 161 Cal.App.4th 465 (2008) invalidated the courts' graduated filing fees for probate cases based on the value of the estate to be probated, ruling that the fees, which totaled almost $75,000 in this case, were an estate tax prohibited by 1982's Proposition 6, which repealed California's estate tax. Of primary interest to local governments are the court's conclusions that the fee was an *ad valorem* tax because it was based on the value of the estate and not the cost of administering the probate case and its discussion of regulatory fees. On the latter issue, the Court stated "a regulatory fee is not compulsory where the payor chooses to engage in the activity, such as developing property. … Unlike a developer fee or the paint manufacturer who decides to sell paint, the probate of the decedent's estate is not an option." It is required by law. This case thus sheds some light on the characteristics of a lawful regulatory fee which can be imposed without voter or property owner approval.

8. Judicial Review of Tax Challenges.

California Logistics, Inc. v. State of California, 161 Cal.App.4th 242 (2008), a case involving state payroll taxes, provides a useful restatement of the rule that those who would challenge taxes must pay them first and then sue for a refund. The case applies § 32 of Article XIII of the California Constitution, which the courts have concluded applies to local governments (but which point is at issue in the *Ardon* telephone tax and Anaheim bed tax cases discussed above).[9]

A similar result was reached in *JP Morgan Chase Bank, N.A. v. City and County of San Francisco*, 174 Cal.App.4th 1201 (2009), which concluded that Morgan Chase could not pursue a property tax refund suit because it had failed to file claims within the four-year-period applicable to taxes and charges on the property tax roll under Revenue & Taxation Code § 5097.

Jensen v. Franchise Tax Board, 178 Cal.App.4th 426 (2009) is a helpful restatement of a number of basic rules that require judges to defer to legislative judgments about taxes. It rejected a challenge to a 1% increase in the top income tax bracket on those with annual incomes over $1 million to fund mental healthcare services. The Court affirmed that, absent preemptive state or federal legislative or a classification affecting a group entitled to heightened judicial scrutiny (such as strict scrutiny for religious and racial classifications and intermediate scrutiny for gender classifications), courts review tax classifications under the most generous Equal Protection standard – if there is any rational basis for the distinction, the courts will uphold it. Ability to pay is a long-established basis for tax classifications and the wealthy are not a social group entitled to special judicial protection.

A pending California Supreme Court case involves the question whether the constitutional right to jury trial under Article I, Section 16 of our constitution extends to tax refund actions: *Franchise Tax Board v. Superior Court*, 177 Cal.App.4th 36 (2009), *review granted* Case No. S176943. This case involves an income tax dispute, but the principal is of interest in all tax settings. The case was fully briefed in May 2010 and is awaiting argument; decision is not likely until 2011.

9. Dormant Commerce Clause Cases

The Dormant Commerce Clause doctrine holds that Congress' power to regulate interstate commerce preempts state and local legislation which has the effect of discriminating for or against inter-state commerce. The California Constitution has been interpreted to impose similar requirements on local taxes with respect to inter-city commerce. The liabilities which arise when tax schemes are found to violate this requirement can be substantial. A recent decision, helpfully identifies was to manage such liabilities.

---

[9] A similar holding in a case involving sewer charges is discussed in section 14 below.

River Garden Retirement Home v. Franchise Tax Board (2010) 186 Cal.App.4th 922 involved the aftermath of a Court of Appeal decision invalidating a Re. & Tax Code section allowing California corporate taxpayers to deduct from taxable income dividends from corporations taxed by California by not dividends for corporations in other states. The Franchise Tax Board adopted a rule retroactively disallowing the deduction to taxpayers which had taken advantage of it to cure the discrimination in favor of California corporations. River Garden was such a taxpayer and contested a proposed assessment for additional tax, arguing that the only remedy permitted was to extend the tax deduction to all corporate dividends, not to disallow the deduction retroactively. The Court of Appeal concluded the FTB's rule did not offend due process or adopt a new tax requiring ⅔ approval of each chamber of the Legislature under Prop. 13. It also found that retroactive taxation was permissible provided that the length of retroactivity was reasonable and justified by the policy context. While the case is a helpful suggestion of how to fashion remedies in a Dormant Commerce Clause case, its application to local government will be difficult given the rule of Proposition 218 that any change in the "administrative methodology" by which a tax is implemented that increases tax liability for any taxpayer is a tax "increase" requiring voter approval.

10. Challenge to Proposition 13

In light of the current State budget crisis and perhaps due to the challenge to Proposition 8's ban on gay marriage on the ground that it revised the State Constitution by initiative rather than amended it (revisions may be initiated only by the Legislature), former Chancellor of the University of California Charles Young filed suit to invalidate – some 33 years after it was adopted – Proposition 13's requirement that new state taxes be approved by a ⅔ vote. The case is *Young v. Schmidt*, Los Angeles County Superior Court Case No. BC 422770; the defendants are the clerks of the Senate and the Assembly. The California Supreme Court rejected a broad range of challenges to Proposition 13 shortly after it was adopted in *Amador Valley Joint Union High School Dist. v. State Bd. of Equalization* (1978) 22 Cal.3d 208. Moreover, the Court has struck down initiative constitutional amendments as unauthorized revisions only twice – once in the 1930s and once more recently. For these reasons, the case seems a bit of a long shot. The Supreme Court rejected this case without reaching the merits when it was initially filed in that court and it has been refiled in Los Angeles Superior Court and as this paper is written a motion for judgment on the pleadings is set for argument on August 30, 2010.

11. Veterans Business License Tax Exemption

Business & Professions Code § 16102 requires local governments to exempt honorably discharged military veterans who engage in retail activities from business license requirements. in __ Ops. Calif. Att'y Gen'l ___, 2010 WL 2888357 (July 19, 2010), Attorney General Jerry Brown's office concluded that this law does not permit the State Board of Equalization to extend this exemption to sales taxes paid by purchasers from retailers who qualify for this exemption

from business license taxes. The result is unsurprising, but the opinion provides a useful reminder of the business license exemption.

12. A Fee to Administer a Tax is a Tax

Weisblat v. City of San Diego, 176 Cal.App.4th (2009) found that a $25 per year fee imposed on businesses subject to the City's Rental Unit Business Tax (RUBT) is not a permissible regulatory fee, as the City contended and the trial court found, but rather a void, non-voter-approved, general tax. The Court found as a matter of law on what it characterized as "undisputed facts" that this fee was imposed for revenue-raising purposes and not for regulatory purposes:

> It is also undisputed that the purpose of the levy is to recover the costs associated with the administration of the Business Tax and RUBT programs, including the cost of collecting and processing the Business Tax and RUBT payments, printing and postage fees, and the cost of computer systems and overhead. The levy is not exacted in return for permits or other governmental privileges.

The gist of the case was the Court's conclusion, based on the staff report that supported the fee and staff declarations submitted in support of it, that the fee was imposed to recover the cost of administering the RUBT in order to offset state takeaways of City tax revenues and that there was no evidence of any regulatory services or benefit to taxpayers provided by the staff whose positions were funded by the fee. The act of issuing tax bills was not, in the Court's view, a "service" even though the tax liability would exist even if no bill issued.

The Court concluded the fee was a general, not a special, tax. This is somewhat surprising given the fact that use of the proceeds of the fee was restricted to funding costs to collect the RUBT both by the resolution imposing it and by the City's practice in administering it. The Court reached this conclusion because the fee was imposed to offset state impacts on the general fund and the general fund indirectly benefits because the proceeds of the fee fund services previously supported by the general fund. That logic would allow every tax to be construed as a general tax subject to majority approval. A potentially persuasive counter-argument is that, notwithstanding the stated purpose of this fee and use of its proceeds, it is effectively part of the RUBT itself and, because the RUBT is a general tax, this de facto increase of that tax is also a general tax.

So what do we make of this case in practical terms? A few thoughts:

1. The resolution or ordinance adopting a tax, the staff report, and other legislative history should clearly state the regulatory or service rationale for a fee. Discussions of the fiscal impact of the measure should be carefully reviewed by counsel to avoid supporting an argument it is imposed merely to raise revenue.

2. Existing fees imposed to enforce taxes should be reviewed in light of this case. A regulatory purpose – other than mere tax collection – should be articulated for these fees.

San Diego did not seek rehearing or review and the case is now final.

13. Utility Rates

Conservation Rates: A.B. 2882 (Wolk, D-Davis), effective January 1, 2009, authorizes water providers to impose tiered water-rate structures that reward conservation and penalize overuse of water. Although the measure states that "[t]he authority granted in this chapter is in addition to any other authority that a public entity has to use rate structure design to foster the conservation of water," its very specific rules for conservation rates may become politically mandatory in some communities and will be argued by those who wish to persuade a court that other means to set such rates are inadequate. Among the bill's requirements are: conservation rates must be based on metered water use; the base rate must reflect a water volume "that provides a reasonable amount of water for the customer's needs and property characteristics;" and, a conservation charge can be imposed above the base rate for overuse, but must be designed to recover the incremental costs associated with the supply of water to those who consume more than the base amount. The bill provides some discussion of Proposition 218's poorly defined requirement that property related fees be "proportional" to the cost of serving the parcel on which a fee is imposed;[10] stating that proportional cost shall be determined after considering customer classes that reflect service characteristics, demand patterns and other factors; base water amounts, metered volume of water consumed, and the tiered water rate structures established by the agency. The bill also authorizes a customer to challenge whether a basic use allocation is reasonable.

To the extent this bill attempts to alter the requirements of Proposition 218, it cannot do so. To the extent that it merely implements Proposition 218, it is hard to see why it is needed. Case law allows local governments to impose tiered rate structures and cost justifications for such rate structures can be fashioned. It does provide black-letter authority for tiered rates, however, and that may provide political cover for agencies which wish to impose such rates and want a simple answer to critics who question their authority to do so.

All agencies which impose tiered rates would do well to consider the criteria of this bill, as its provisions are something of a safe harbor and failure to comply with its criteria may make a rate structure more vulnerable to challenge.

Utility Rate Pass-Throughs: A similar "helpful" bill from 2008 that reduces local authority is A.B. 3030 (Brownley, D-Santa Monica) which expressly authorizes utility rate

[10] More guidance on this issue is available from the *Bonander* case discussed above in section 24 of this paper.

structures subject to Proposition 218 protests to include inflation adjustment features and pass-throughs of wholesale rates, as for water. However, authority for such rate structures existed previously and by codifying that authority, this bill narrows it. Specifically, wholesale pass-throughs are authorized for water costs only – not for labor, energy and other elements of an agency's service cost for which some rate structures have provided pass-throughs.[11] Pass-throughs and inflation adjustment devices will be limited to five years, at which point a new Proposition 218 proceeding will be required. Implementation of a pass-through or inflation adjustment requires 30 days' notice to customers before each rate adjustment. While such notice can be given via a utility bill, this provision will be expensive and problematic for agencies which collect such fees via the property tax roll, as an agency-wide mailing will now be required. It will also be problematic for agencies which use cycle billing, in which only a portion of their customers are billed at a time. In short, although the bill was intended to help local governments, it reduces their authority and raises their costs.

Connection charges: 2008's S.B. 1124 (Local Government Committee), the annual omnibus bill on local government issues included an amendment to Health & Safety Code § 5474, which is commonly used by local governments to set sewer and other utility rates. It allows an agency which provides sewer service to impose a connection charge for up to 30 years to support debt which can constitute a lien on affected properties after a relatively simply public hearing. Because connection charges are paid by new development, they are not subject to Proposition 218 under *Richmond v. Shasta Community Services District,* 32 Cal.4th 409 (2004).

Minimum Utility Account Charges: Paland v. Brooktrails Township Community Services District Board of Directors, 179 Cal. App.4th 1358 (2009) holds that a minimum monthly charge for water service imposed without respect to actual use of water was properly included in a water rate regime approved under Prop. 218's majority-protest process and was not an assessment for which a mailed-ballot "assessment protest" was required under Prop. 218. Prop. 218 imposes a number of restrictions on how local governments may use revenues obtained from property related fees and some limits on what services these fees can fund. Among these is § 6(b)(4), which states:

> 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.

Under this rule, standby charges – such as charges collected via the property tax roll on undeveloped properties to fund capital improvements to utility systems so those properties can be served in the future – cannot be imposed as other charges are. They must be imposed as

[11] The bill makes no reference to such other pass-throughs and, arguably has no effect on existing authority to implement them.

assessments with property owner approval in a mailed-ballot protest proceeding. As few property owners can be expected to vote to pay for a service they do not yet need, few agencies have increased such standby fees or imposed new standby fees since Proposition 218 was adopted in 1996. Such fees do make economic sense, of course, because the availability of utility service makes property developable and therefore much more valuable than property which cannot be developed. In addition, there is a real cost to maintain capacity for such future development that current utility customers ought not to be required to pay.

No court until the *Paland* case considered when a utility service is "immediately available to" property owners and when a fee is based only on "potential or future use." In *Paland*, the Brooktrails Township CSD, which serves some 1,500 parcels in and near Willits, imposed a water rate structure, common to many utilities, which combined a minimum monthly fee for active accounts with a volumetric charge based on the amount of water consumed in a billing period. In this case, the District charged its minimum fees even though it had turned off and locked Mr. Paland's meter for non-payment. Paland sued, seeking declaratory and injunctive relief that the fees could not be charged because water service was not immediately available to him and the fee was therefore a standby charge made subject to Proposition 218's assessment rules by Article XIII D, § 6(b)(4), quoted above.

The San Francisco Court of Appeal disagreed:

> [W]e conclude the water and sewer base rates imposed on parcels with water or sewer connections regardless of whether they are active or inactive, and whether or not the property owner uses the services, are fees subject to the provisions of article XIII D, section 6, not assessments subject to the requirements of article XIII D, section 4.

Id. at 1371.

This is not a surprising result – Proposition 218's intent to treat local government fees for water, sewer and government-provided trash service more leniently than other fees is plain and minimum monthly account charges are a very common feature of water rates because water utilities have very large fixed costs and only a small portion of their costs relates to how much water is consumed. This is because they have to maintain their entire system and pay a staff to do so, whether they sell one drop of water or all they can deliver. However, the fact that Paland's meter was locked for non-payment does make this case a bit less obvious than it would otherwise have been.

The Court confirms that utility service fees may properly recover capital costs and that provisions in Proposition 218 and other laws **allowing** assessments to be used for that purpose do not **require** that assessments be used. *Id*. at 1367, n.11. The Court explained that a property related utility service is "immediately available" to a property owner, such that rates are subject

only to the majority-protest requirement if the property owner alone can take the steps necessary to make use of the service. *Id*. at 1367-71. The Court rejected Paland's argument that the CSD could recover the capital cost of providing a utility system to serve him only once, via an initial connection fee, affirming that utility rates may recover both capital and operation costs. *Id*.

The result of this case is not surprising. It is helpful, however, to have such plainly stated affirmation that the common practices of public water providers – to charge minimum monthly charges to all active accounts – is permissible without voter or property owner approval, provided that the rate structure itself has been the subject of the majority protest proceeding required by Proposition 218. It also provides a firm rejection of the common argument that periodic utility fees may not recover capital costs.

Procedure for Increasing Property-Related Fees . Foster Poultry Farms, Inc. v. City of Livingston, 5th District Court of Appeal Case No. F059871 is the City's appeal from a ruling of the Merced County Superior Court invalidating the City's water rate increases. The trial court concluded, erroneously in the opinion of this paper's author, that a general law city cannot raise water rates without the ⅔-approval of its City Council (four votes out of five) required to place utility rates on the tax roll under Health & Safety Code § 5471 (even though Livingston collects its water rates on utility bills). The trial court also concluded that the City could not: (i) give notice of more than one rate proposal, (ii) continue its hearing on the rates without 45 days' mailed notice of each new hearing date, or (iii) impose rates in amounts lower than those of which it gave notice. The Court also faulted the City for failing to include in its notice of the proposed rates the fact that some of the funds to be raised by the rate increase would repay the City's general fund for previous loans to the water enterprise fund. The case is now being briefed. The controversy sparked by the rate increase also lead to a recall election slated for August 31, 2010. The League of California Cities, the California State Association of Counties and the Association of California Water Agencies provided amicus support for the City in this case.[12]

14. 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

[12] The author of this paper wrote that *amicus* brief in collaboration with San Diego County Water Authority General Counsel Daniel S. Hentschke.

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 requirement of a mailed ballot vote of property owners or ⅔-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 in April 2005. Rancho Palos Verdes adopted such a fee by a very narrow margin and opponents obtained sufficient signatures under the very low standard of Proposition 218's Article XIII C, § 3 to place the matter on the November 2007 ballot for repeal; the repeal measure was rejected, although a companion measure placed on the ballot by the City was approved to revise the fee. The coastal community of San Clemente also succeeded in adopting a property related fee for water-quality programs. Encinitas' Clean Water Regulatory Fee adopted without voter approval in 2005 drew challenge by the Howard Jarvis Taxpayers Association 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 its fee, as well.

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 *Howard Jarvis Taxpayers Ass'n v. City of Roseville* (2002) 97 Cal.App.4th 637 and *Howard Jarvis Taxpayers Ass'n v. City of Fresno* (2005) 127 CAl.App.4th 914 to the extent it can be shown that utility operations impose costs on storm water programs 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).[13] That Court concluded that a fee on the property tax roll based on the amount of impervious coverage maintained on a parcel was a property-related fee subject to Prop. 218 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 A.B. 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 storm water pollution from roadways in the County. *See*

[13] The author of this paper represented Salinas in drafting the fee, in the trial court, and on an unsuccessful petition for review to the California Supreme Court.

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 Tom 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 ⅔-voter election. ACA 10 never got a hearing in the 2003-04 Legislature and ACA 13 met the same fate in the 2005-06 Legislature. Neither proposal got the support of a single Republican legislator other than its 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 in August 2006.

Senators Torlakson (D-Antioch) and Yee (D-San Francisco) tried again in 2006 with SCA 12, which would have amended Article XIII D, § 6(c) to add "urban runoff management" to the list of services for which property-related fees do not require voter- or property-owner-approval. The matter did not make it to the Senate floor. Notably, Senator Harman voted against the measure in committee, stating that he had changed his opinion on the proposal following his sponsorship of ACA 10 and ACA 13 due to his support for Proposition 218. He has thus returned to the current Republican orthodoxy on these issues.

Assemblyman Calderon's (D-Whittier) A.B. 938 was originally written as a comprehensive effort to address clean-water mandates on local government and to authorize local governments to impose regulatory fees on those whose activities create urban runoff. In August 2008 it was stripped down to a statement of intent and died in the Senate Rules Committee.

The latest proposal along these lines was SCA 18 (Liu, D-LaCanada-Flintridge and Yee, D-San Francisco). It died on the Senate floor in summer 2009 after party-line votes in two

committees. The Republican support necessary to achieve ⅔ approval in each chamber of the Legislature is nowhere in evidence.

Effective January 1, 2010 Senator Ducheny's (D-San Diego) SB 310 authorizes a county, city, or special district, or combination thereof, to impose fees on activities that generate or contribute to runoff, storm water, or surface runoff pollution to pay the costs of a watershed improvement plan or the implementation of such a plan approved by a regional water quality control board. However, such fees must comply with Proposition 218, which will likely require property-owner or voter approval.

On March 28, 2010, the Commission on State Mandates found that 10 stormwater-related programs mandated by the San Diego Regional Water Quality Control Board constitute reimbursable mandates: street sweeping and reporting, storm drain cleaning and reporting, education requirements, watershed urban runoff management program, regional urban water management program, program effectiveness assessment, long-term effectiveness assessment and mandated collaboration among the County and 21 cities within it – the co-permittees under the permit for the municipal separate stormwater system. This decision may well be litigated and the outcome of that litigation will greatly affect every local government in the state.

15. <u>Groundwater Extraction Charges</u>

In *Pajaro Valley Water Management Agency v. Amrhein*, 150 Cal.App.4th 1364 (2007), the 6th District Court of Appeal in San Jose ruled that a groundwater extraction charge levied to fund groundwater basin replenishment and other water supply programs was a property related fee subject to Prop. 218. While the case is of most significance for groundwater management agencies and those (including municipal water utilities) who pay charges to those agencies, it also provides some guidance for local governments which wish to fashion regulatory fees exempt from Prop. 218.

The trial court found the fee to be exempt from Prop. 218. Initially, the Court of Appeal affirmed, concluding that the fee in issue was not property related. That decision, however, came two days after the California Supreme Court decided *Bighorn*. Because its initial decision was inconsistent with *Bighorn*, the 6th District granted rehearing in the *Pajaro Valley* case and reversed the trial court.

A two-judge majority concluded that the fee was not a special tax primarily because the cases cited by the opponents of the fee holding other kinds of revenues to be taxes were not on point. Agencies which wish to distinguish a revenue measure from a tax should note several crucial aspects of the charge in issue here: the amount of the charge did not exceed the cost of the regulatory program it funded, fee proceeds could only be used to fund that program, and fee payors benefit from the program and create the environmental problems it addresses – the fee

was imposed on those who pump groundwater and not merely those who own property or live in the area served by the Agency.

Next, the majority concluded that the charge was not an "assessment" because it is not secured by an automatic lien on property, but could become a lien only as a judgment lien following a debt action. Prop. 218 defines the assessments it regulates as "a levy or charge *upon real property*."[14] The charge in issue here is not imposed on real property and collected via the tax roll, but billed to those who operate groundwater wells, many, but not all, of whom are property owners. The Court rejected the fee opponents' claim that, because the charge had a capacity component (*i.e.,* a charge for existing or planned capital facilities)[15] it was necessarily an assessment, citing *Richmond v. Shasta Community Services District*, 32 Cal.4th 409, 422 (2004), which had rejected this same argument in a case holding that connection charges for new development are not property related fees subject to Prop. 218.[16]

The Court concludes the Agency's fee was a property related fee subject to Prop. 218. It noted the tension between *Bighorn*'s conclusion that water service charges are subject to Prop. 218 and *Apartment Ass'n of Los Angeles County, Inc. v. City of Los Angeles*, 24 Cal.4th 830 (2001). In that earlier decision, the California Supreme Court ruled that a property-tax-roll fee on landlords to fund housing code enforcement was not imposed "as an incident of property ownership" but on voluntary decisions to operate rental housing businesses. Voluntary decisions of that sort can be subject to non-Prop. 218 fees to fund business regulation. Thus, the question was: Is the *Pajaro* fee more like a water service charge or more like a regulatory fee on those who voluntarily pump groundwater in a manner that is causing discernible harm?

The Court concluded that this fee was a water-service fee subject to Prop. 218. The Court appeared to be swayed by the fact that the fee was imposed on 660 agricultural users and 3,000 residential well owners and that, while the majority of the fees were paid by farms, there was no exemption for domestic water use. From the Court's perspective, the fee an urban water user pays for metered service is not meaningfully different from the fee a rural residential well operator pays for groundwater replenishment and both fees should be subject to Prop. 218. The Court did note that a fee on those who consume more water than needed for domestic use would not be subject to Prop. 218 and that a fee on those who produce water for agricultural use would likewise be outside the measure. The Court also suggested that the fee might have been non-property related and exempt from Prop. 218 if it had a clearer regulatory purpose.

---

[14] California Constitution, Art. XIII D, § 2(b).
[15] Gov't Code § 66013(b)(3): "'Capacity charge' means a charge for public facilities in existence at the time a charge is imposed or charges for new public facilities to be acquired or constructed in the future that are of proportional benefit to the person or property being charged, including supply or capacity contracts for rights or entitlements, real property interests, and entitlements and other rights of the local agency involving capital expense relating to its use of existing or new public facilities. A 'capacity charge' does not include a commodity charge."
[16] The author of this paper was counsel for the successful local government in the *Richmond* case.

The issues addressed in *Pajaro* have generated further litigation. In April 2009, a trial court invalidated a similar groundwater extraction charge imposed by the Santa Clara Valley Water District on cities, private water companies, and others who produce groundwater in the Santa Clara Valley. The court invalidated the fee because it had not been subject to a property-owner election under Article XIII C, § 6(c) (which does not apply to water, sewer and solid waste charges). The court also found that the District violated its principal act by overcharging for its services, requiring municipal and industrial water users to subsidize agricultural water users (which the act actually required, but not to the extent the court found to have occurred), and misusing proceeds of the fee for purposes other than groundwater replenishment. The District has stated that it intends to appeal. In November 2009, the court awarded more than $4.6 million to the plaintiff in the case and the District's appealed in February 2010. The case is *Great Oaks Water Company v. Santa Clara Valley Water District*, 6th DCA Case No. H035260 and the District's opening brief has not yet been filed as this paper is written. The District has entered into tolling agreements with other payors of the groundwater extraction charges to preserve refund claims pending resolution of the Great Oaks case. Public agencies which pay the District's fees may wish to pursue such agreements.

The 3rd District Court of Appeal in Sacramento suggested in a pre-argument order that it may be prepared to reject *Pajaro* but discussion at oral argument suggested the Court views the case as moot. The case is *North San Joaquin Water Conservation District v. Howard Jarvis Taxpayers Association*, 3rd District Court of Appeal Case No. C059758. The District filed this validation action to confirm its groundwater charge on parcels served by private wells. The HJTA answered the complaint, arguing that a § 6(c) election was required. The trial court struck the validation cause of action as unauthorized by statute but granting declaratory relief to the District. HJTA appealed. In addition to its § 6(c) election argument, HJTA argues that the 5 to 1 ratio of fees on municipal and industrial water users to the fees on agricultural users violates the requirement of Article XIII D, § 6(b)(3) that property-related fees be proportional to the cost of service. The case divides local government interests – as water retailers (such as many cities) can agree that groundwater services are exempt from § 6(c) elections, but desire the protection of the § 6(b)(3) proportionality requirement to eliminate agricultural subsidies which are commonly required by statutes authorizing groundwater replenishment charges. The Association of California Water Agencies provided *amicus* support for the District in this case.

Before the June 28, 2010 argument, the Court of Appeal requested supplemental briefing on these questions: (i) whether the groundwater charge is assessed upon a parcel or a person as an incident of property ownership such that it is subject to Prop. 218 at all; (ii) whether it is for a property related service (triggering Prop. 218) and (iii) whether *Pajaro* was correctly decided. However, at oral argument the Court's questions suggested the panel may view the case as moot because the charge in issue was repealed by initiative. Decision in the case is due by September 27, 2010.

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 California Supreme Court Case No. S150518. 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 impose 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 ⅔-approval of the each house of the Legislature under Proposition 13.[17]

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 California, 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 (such as the Bureau of Reclamation), which control 22% of water rights in the state, and cannot shift the cost of its services to federal contractors in lieu of imposing regulatory fees on the federal government itself.

The California Supreme Court granted review of the case, which means the appellate decision is no longer citable authority. The case was fully briefed by October 2008 and awaits an argument date as this paper is written.

16. Payment Under Protest Required for Fee Challenge

Los Altos Golf & County Club v. County of Santa Clara, 165 Cal.App.4th 198 (2008) reaffirms the longstanding rule that a property owner cannot challenge a sewer service fee without first paying that fee under protest. The result barred a class action challenge to the fee. The case construes the requirements of the Health & Safety Code §§ 5471, et seq., which are commonly relied upon by local governments to collect fees on the property tax roll. Further discussion of the "pay first, litigate later" rule appears in sections 4 and 6 of this paper above.

[17] California Constitution, Article XIII A, § 3.

17. Traffic Impact Fees

A.B. 3005 was approved in 2008 to adopt Government Code §§ 65460.1 and 66005.1 to require local governments to reduce traffic impact fees on housing developments within one-half mile of a transit station.

18. Affordable Housing Fees

Building Industry Ass'n of Central California v. City of Patterson, 171 Cal.App.4th 886 (2009), *review denied*, involved a challenge to a fee imposed on developers who elected to pay a fee rather than to include affordable housing in their projects. The City and Morrison Homes entered into a development agreement entitling the developer's project while a review of the City's affordable housing fee was underway. The agreement therefore stated, "Developer acknowledges that the City is currently preparing an updated analysis of its Affordable Housing fee and hereby agrees to be bound by the revised fee schedule … provided the fee is reasonably justified." The very conservative 5th District Court of Appeal in Fresno found "reasonably justified" to require demonstration of a reasonable relationship between the impacts of the developer's project and the need for affordable housing in the City – *i.e.,* the constitutional standard for mandatory exactions which is not typically applied to voluntary agreements like a development agreement. Although the case can be distinguished from most other impact fee disputes because of the particular language of the agreement in issue, it is a cautionary tale for local governments that development agreement language must be drafted with great care.

Homebuilders Ass'n of Tulare / Kings Counties, Inc. v. City of Lemoore (2010) 185 Cal.App.4th 544, *pet'n for depublication pending*[18] is a helpful case for local governments. It as an unsuccessful effort by the Homebuilders Ass'n to narrow the power of local governments to impose development impact fees. The decision makes a few noteworthy points. First, a respondent agency bears the burden to produce record evidence to support its fee but not the burden of proof, notwithstanding language to the contrary in *Beaumont Investors v. Beaumont-Cherry Valley Water District* (1985) 165 Cal.App.3d 227and cases citing it. Second, a fee can be justified by adopted city or county standards for ratios of facilities to population and need not be based on a capital improvement plan identifying specific facilities which will benefit identified developments. Third, the Quimby Act, Gov't Code § 66477, a provision of the Subdivision Map Act authorizing local governments to require subdividers to dedicate land for local parks, does not preempt A.B. 1600 (Gov't Code §§ 66000 et seq.) fees for park and recreation facilities. The Court reserved the question whether a naval air museum and an aquatic center could be shown to be reasonably related to a development and the concurring opinion by the soon-to-retire Justice Ardaiz states his view that the answer would be "no" if the question were properly before the Court. The court found that an AB 1600 fee could not be used to reimburse the general fund for

[18] The author of this paper filed a *pro per* opposition to depublication of this decision at the request of the City of Lemoore.

its investment in existing fire facilities where the fee study showed existing facilities to be sufficient to serve projected development. Finally, the court rejected the claim that an AB 1600 fee could not be used to buy trash trucks and bins because service fees could fund this service.

19. Property-Related Fees for Water Quality and Flood Control Programs

Greene v. Marin County Flood Control and Water Conservation District (2010) 49 Cal.4th 277 is an important victory to local governments. The case is the California Supreme Court's first decision involving the procedures required by Prop. 218 for the adoption of property-related fees, including water and sewer fees. Previous cases involving fees under Prop. 218 had focused on what fees are covered by the measure. While a narrow ruling, it upheld the District's fee. It also ruled that the Prop. 218 Omnibus Implementation Act of 1997, drafted as a collaboration of taxpayer and local government advocates, is good law for construction of Prop. 218. Finally, it concluded that local governments may adopt rules to conduct elections among property owners on property-related fees so long as those rules do no conflict with the few bright-line rules provided by Prop. 218. The case will provide important guidance for all local governments which impose property-related fees for such services as water, sewer, flood control and water quality.

These conclusions helpful to local government and provide means to clarify the procedures required by Prop. 218, which are not especially well stated in the measure itself, and some degree of flexibility to adapt those procedures to particular situations.

The Court of Appeal in this case had held that the voting secrecy requirement of the California Constitution applies to property-owner elections on property related fees under Prop. 218. The District imposed a property related fee for flood control purposes in the Ross Valley following a devastating flood of December 31, 2005. As required by Prop. 218, it held a majority-protest hearing and no majority protest was filed. It then held an election among property owners as Prop. 218 also requires. The last sentence of that the section of Prop. 218 imposing that requirement states: "An agency may adopt procedures similar to those for increases in assessments in the conduct of elections under this subdivision." Accordingly, the District required voters to print their names and to sign their ballots as is required for assessment protest ballots. The measure was approved, although many ballots were disqualified because voters ignored multiple instructions to sign their ballots.

A lawyer suing as the petitioner (*i.e.,* as his own client) – and a candidate for the San Anselmo Town Council when the case was filed (and now a Councilmember) – filed an election challenge, arguing that the District had given insufficient notice of the requirement to sign ballots and that requiring voters to sign their ballots creates an irrational distinction violating equal protection between those who signed their ballots and those who did not. The Marin County Superior Court ruled for the District and the petitioner appealed, arguing that the election violated the voting secrecy rule of the California Constitution, which applies to elections among

registered voters. The Court of Appeal concluded secrecy was required, but the Supreme Court reversed.

Several aspects of the decision are worth noting in addition to its core holdings. First, the provision of the Prop. 218 Omnibus Implementation Act requiring **assessment** ballots to be kept secret until counted and made available for public inspection thereafter is constitutional and can be used by local governments adopting rules for property-owner balloting on property-related **fees**.

Second, local governments have substantial freedom to determine the form of ballots for property-owner voting. The safe approach, however, is to do what the District did here – follow the model of Prop. 218 for assessments by requiring voters to list their name, address and signature on ballots.

Third, the Court's openness to local and State legislation to fill in the gaps in the property-related fee provisions of Prop. 218 makes clear that efforts by fee challengers to import other Elections Code requirements for conventional elections into the 218 context will not be successful. Just as the argument in this case that property-owner ballots must be secret and cannot have identifying information on them failed; other Elections Code based claims should fail, too.

The case does not decide, as local government advocates had hoped it would, whether property-owner ballots may be weighted to reflect the amount of fee property owners would pay, the amount of land involved, or some other measure of fairness in an election among large and small property owners. However, the decision does reaffirm a long line of cases holding that property-owner voting (as in reclamation and other districts which provide services to land) is not subject to ballot secrecy. This bodes well for future fights about weighted voting in property-owner elections.

The Court also discussed its recent decision in *Silicon Valley Taxpayers Ass'n v. Santa Clara County Open Space Authority* (2008) 44 Cal.4th 431, which established an "independent judgment" standard of searching judicial review of local government decisions regarding the special benefit to be afforded by an assessment and the allocation of assessment amounts in proportion to the special benefit afforded each property. It found that case inapplicable here because the validity of the District's form of property-owner ballot and its rules for property-owner voting raised questions of law which courts review independently under older, basic rules regarding the relative roles of legislators and courts.

Local governments will have to rely on further litigation to flesh out the questions not resolved here, such as further limits on the scope of *Silicon Valley's* independent judgment standard of judicial review and the propriety of weighted voting on property-related fees.

Foster Poultry Farms, Inc. v. City of Livingston, another case involving the procedures for implementing property-related fees is discussed in section 13 of this paper above.

20. Regulatory Fees on Water Rights

S.B. 681 (Pavley, D-Agoura Hills) was an ambitious bill to affect the process by which the State Water Resources Control Board adjudicates disputes regarding the use of post-1914 water rights. Of interest here are its provisions authorizing the Board to impose annual fees on all holders of water rights licensed by the Board – including most municipal water providers – to fund the Board's activities. The bill died in the Senate's inactive file in January 2010. The Governor's budget proposal in January 2010 proposed a range of fees to fund the State's water agencies, so it is possible that some form of state fee on local government water rights and water utilities may be in the offing.

21. Emergency Response Fees

In 1985 the Legislature adopted Government Code §§ 53150 to authorize police departments to recover from drunk drivers the cost of responding the accidents they cause. More recently, local agencies have imposed fees for other public safety response costs, such as a fire department's response to a traffic accident. Private agencies have sprung up to help local agencies develop, implement and collect such fees and, the recent economic downturn has encouraged agencies to do so. A.B. 1004 (Portantino, D-La Canada-Flintridge) was introduced to prohibit such fees but, after discussions with local government officials, was amended merely to prohibit distinguishing between residents and non-residents of a community in the amount of such a fee. In June 2009, with the measure pending adoption on the Assembly Floor, Assemblyman Portantino asked that it be moved to the Assembly's inactive file. It has since been chaptered as a statute which addresses a different topic.

A related case is *City of Los Angeles v. Superior Court*, 168 Cal.App.4th 422 (2008), in which class action lawyers challenged the City's collection of emergency response fees under Government Code Sections 53150 et seq. The city defended on the basis that members of the asserted class had not filed claims for refunds under the Government Claims Act, and the trial court ruled that claims were not required. The city sought a writ in the Court of Appeal which determined that claims were required and remanded the matter to the trial court. The certification of a class was not challenged and the Court of Appeal did not comment on that issue. The Supreme Court denied a petition for review and the case is now final. Along with *Ardon's* rejection of *Oronoz* as discussed in section 1 of this paper above, it is helpful case to preserve local government's power to require compliance with claiming requirements in tax and fee refund cases.

A similar class action suit was pending against the California Highway Patrol in December 2009: *Allende v. California Highway Patrol*, Alameda County Superior Court Case

No. RG 0312 7404. Although Judge Steven Brick granted a partial judgment to the state, the matter remains pending in that court as this paper is written.

22. Development Impact Fees

A.B. 1084 (Adams, R-Hesperia) took effect January 1, 2010 to adjust notice and hearing procedures for development impacts fees subject to Government Code Sections 60000 et seq., commonly known as "AB 1600 fees." The procedures are not onerous and are comparable to those for other fees.

23. Regulatory Fees

California Building Industry Ass'n v. San Joaquin Valley Air Pollution Control District, 178 Cal.App.4th 120 (2009), *review denied*, involved a challenge to the District's indirect source rule, which requires developers to include measures in their developments to mitigate air quality impacts or to pay an in lieu fee. The fee was calculated with respect to the number of vehicle trips to be generated by the project (as estimated in the land use authority's CEQA review of the development) and the fee proceeds were used to fund projects to enhance air quality in the district. The development industry challenged the fee, arguing it was a development impact fee subject to the requirements of AB 1600, the Mitigation Fee Act. The Fresno Court of Appeal disagreed, concluding the fee was a proper regulatory fee. The case helpfully discusses the requirement of *Sinclair Paint Co. v. State Board of Equalization* (1997) 15 Cal.4th 866 that regulatory fees be proportional to the cost of the regulatory program they fund and to the social or economic burden caused by the regulated entity. That discussion may be helpful in giving substance to the as-yet poorly defined proportionality requirements of Proposition 218 for assessments (article XIII D, § 4) and property related fees (article XIII D, § 6(b)(3)).

Health & Safety Code § 18931.6 requires every building official to collect a $4 fee on building permits to fund the development of the State's green building standards. El Dorado County Counsel Lou Green has requested an Attorney General's opinion as to whether this statute imposes an unlawful tax and that request is pending as Opinion Request No. 09-903.

Proposition 26 on the November 2, 2010 ballot would essentially rescind the Sinclair Paint case and reduce the authority of the State and local governments to impose a broad range of regulatory fees. It is the latest threat to local control in government finance and might further complicate State budget negotiations. Prop. 26 would recategorize a swath of state and local fees as taxes, imposing supermajority approval hurdles for what are now regulatory and impact fees that can be adopted by simple majorities of the State Legislature, city councils, and county boards of supervisors.

In 1997 the California Supreme Court ruled in *Sinclair Paint Co. v State Bd. of Equalization* that a fee imposed on makers of products containing lead to fund health services to

children and to otherwise mitigate the social and environmental consequences of lead contamination. The challengers had argued the measure should have been imposed as a tax with ⅔ approval of each chamber of the Legislature under Prop. 13 rather than as a majority-vote regulatory fee. The Court ruled that the use of the proceeds of a fee need not benefit those charged to avoid characterization as a tax as long as the fee bears a reasonable relationship to the burden imposed by those charged. Fees of this kind are called "regulatory fees." In recent years, California courts have upheld such fees imposed to regulate point-source emitters of air pollution and an air quality district's fee on new development to mitigate the impacts of that development on air quality. Fees have been proposed to mitigate the adverse social or environmental consequences of other products and economic activities, too, such as fees on sweetened beverages to fund anti-obesity programs, fees on alcohol vendors to fund police services and public education efforts to address the adverse consequences of alcohol consumption.
In addition, the state budget struggles of recent years led to a number of proposals in the State Legislature to avoid the need for two-thirds approval of new revenues, such as a proposed surcharge on vehicle license fees (VLF) to fund state parks and a December 2008 proposal to reduce state taxes on gasoline, but to increase fees on gasoline to fund public transportation and other programs.

Prop. 26 would recategorize as taxes many regulatory fees that benefit the public broadly rather than providing a direct and distinct benefit to the business owner or other fee payor. Among these are regulatory fees and assessments to address the health, environmental and other social effects of business activities. The ballot arguments regarding the measure also identify a number of fees which it may affect, such as oil spill mitigation fees, hazardous waste clean-up fees, fees on tobacco products to fund health programs, fees on alcohol to fund police services and efforts to prevent youth drinking and road impact fees.

Proposition 26 does exclude from its new definition of "tax" the following kinds of fees:

- for a benefit of privilege conveyed (like a professional license or a land use approval)
- for a service or product (like a park and recreation fee)
- to cover certain costs of regulation
- entrance fees for state or local property (but not vehicle license fee surcharges like that proposed by Prop. 21)
- fines imposed by a court or a local government
- local government development impact fees
- assessments and property related fees governed by Proposition 218.

There are a number of unknowns about Prop. 26 that seem certain to generate litigation: What does it mean that a fee must be proportionate to the benefit from or burden on a service or program with respect to which a fee is imposed? Would a fee for gas service, for example,

depend on whether the person using the gas used it to warm a hospital (large benefit from the service) or run a gas grill (smaller benefit)? Probably not, but we don't know for sure.

The measure allows fees for permits, privileges and services only when that permit, privilege or service is not provided to those not charged. Does this mean an end to free and discounted passes and fees for low-income households and seniors?

How much of the traditional cost of a regulatory program is now permitted to be covered by regulatory fees is now in question, especially as to rule-making by regulators – such as the advance planning services of local planning agencies.

Prop. 218 exempted local government fees for gas and electric service from its requirements. Prop. 26 does not include this exemption and it therefore appears that if it is approved, local gas and electric utilities will have a cost-of-service limit on fees that their for-profit competitors do not.

There will be some significant impacts if voters approve Prop. 26. First, and most obviously, regulatory fees such as those upheld in *Sinclair Paint* and its progeny will now be defined as taxes requiring ⅔ voter or legislative approval. Second, franchise fees may now be defensible only to the extent they are a charge for the use of government property – and this might require the government have the power to exclude users from the property if the fee is not paid. This might affect fees on pipeline franchises, cable television franchises, solid waste collection franchises, etc. California Department of Fish & Game fees for the cost to review documents prepared by local governments under the California Environmental Quality Act (CEQA) might no longer be permissible. Finally, as noted above, low-income and senior discounts for various fees and charges might not longer be permitted.

A fuller version of this discussion, with legal references, appears on this paper's author's website at www.cllaw.us under "papers."

24. Assessments under Proposition 218

In July 2008, the California Supreme Court decided its first substantive case under the assessment provisions of Proposition 218. In doing so, it struck down an open-space assessment because it did not demonstrate special benefit to the assessed property as required by Propositions 13 and 218 and because the amounts assessed were not proportional to the special benefits conferred. The unanimous decision establishes a new, more demanding standard of judicial review of local government assessment decisions and has significant implications for assessment financing in California.

The case is *Silicon Valley Taxpayers Ass'n v. Santa Clara County Open Space Auth.*, 44 Cal.4th 431 (2008). The Authority imposed an assessment to fund future, regional, open-space

acquisitions which applied throughout the District (which has a population of 1.2 million) and was $20 per year for all single-family residential parcels. 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 unspecified, future acquisitions and calculating the proportionate benefit from such acquisitions attributed to each property. The San Jose Court of Appeal found; over a lengthy dissent by a well respected, moderately conservative Justice; that open space acquisitions sufficiently benefit property to justify assessment and that the spread of benefit was proper.

This case was the California Supreme Court's first opportunity to consider the assessment provisions of Proposition 218 since glancing reference in the *Richmond* case in 2004 which held that water connection charges were not assessments and a 2001 decision that the Ventura harbor district could not impose assessments to pay a judgment lien because doing so did not provide special benefit to property. Three aspects of *Silicon Valley* are of most interest.

First, the deferential standard of review of assessment judgments established by pre-Prop. 218 decisions is no longer good law. The old standard was established in such cases as *Knox v. Orland*, a 1992 decision upholding a park assessment on parcels in and outside of Orland to fund parks used by the whole community, and *Dawson v. Town of Los Altos Hill*s, a 1976 decision upholding a sewer assessment. In those cases, the Supreme Court ruled that courts will not set aside an assessment unless it clearly appears on the local agency's record, or from facts which may be judicially noticed, that the assessment is not proportional to the benefits bestowed on assessed properties or that no benefit will accrue to those properties. In 2002, the San Francisco Court of Appeal ruled in *Not About Water Committee v. Board of Supervisors* that this older standard of review had survived Prop. 218, notwithstanding language in the measure shifting the burden of proof on these issues from challengers to local governments.

Silicon Valley concludes that Prop. 218 establishes this more demanding standard of review:

> "Courts should exercise their independent judgment in reviewing local agency decisions that have determined whether benefits are special and whether assessments are proportionate to special benefits with the meaning of Proposition 218 … [because] … courts use independent, de novo review for mixed questions of facts and law that implicate constitutional rights."

Thus, courts will give more searching scrutiny to assessments and a meaningful amount of power over assessments has been transferred from local elected officials to the judiciary.

Second, the decision holds that Prop. 218 tightens the definition of the "special benefit" which must be shown to justify assessment financing:

> "A special benefit must affect the assessed property in a way that is particular and distinct from its effect on other parcels and that real property in general and the public at large do not share …. [T]he characterization of a benefit may depend on whether the parcel receives a direct advantage from the improvements (e.g., proximity to a park) or receives an indirect, derivative advantage resulting from the overall public benefits of the improvement (e.g., general enhancement of the district's property values). … [T]o the extent that the value of property located in a desirable community is enhanced, this is a '[g]eneral enhancement of property values," and is thus, by definition not a special benefit."

Citing the Ventura harbor district case, the Court noted, "[i]f everything is special, then nothing is special."

Thus, an assessment engineer's report must demonstrate that the program of improvements or services to be financed will benefit assessed properties in a manner different in kind from the benefit society in general derives from a government service and cannot rest only on the general increase in property values that arises from a well served community.

Third, the decision is the first to analyze Prop. 218's requirement that assessment amounts be "proportional" to the special benefit each parcel receives. This notion of proportionality is poorly defined in Prop. 218 and also has implications for water, sewer and other property-related fees because Prop. 218 also requires such fees to be "proportional" to the cost of service. The Supreme Court's analysis of this point is not especially deep because it perceived the assessment engineer's report in issue to have made no effort to demonstrate proportionality:

> The report's proportionality analysis fails to satisfy Proposition 218 largely because the special assessment is based on OSA's [*i.e.,* the Open Space Authority's] projected annual budget of $8 million for its open space program rather than on a calculation or estimation of the costs of the particular public improvement to be financed by the assessment. …Thus, the report fails to identify with sufficient specificity, the "permanent public improvement" [required by Prop. 218] that the assessment will finance, fails to estimate or calculate the cost of any such improvement, and fails to directly connect any proportionate costs of and benefits received from the "permanent public improvement" to the specific assessed properties. As the dissent below observed, "an assessment calculation that works backward by starting with an amount taxpayers are likely to pay, and then determines an annual spending budget based thereon, does not comply with the law governing assessment, either before or after Proposition 218."

So, what does the case mean in practical terms? A full answer to that question will develop as lower courts apply the case, but we offer a few initial observations: First, open space

assessments, regional park assessments and other assessments that provide broad and diffuse benefit to a large area and that benefit all members of society – tenants, landowners and visitors alike – have always been difficult to justify as conferring special benefit sufficient to be assessments and not special taxes (for which ⅔-voter approval is required). This case makes that burden heavier still. Thus, great care will now be required in drafting engineers' reports for such assessments and legal review of those reports is essential. For some programs of this type, local governments may wish to consider special taxes, general taxes (which require majority voter approval), or non-property-related fees such as inspection and service fees (which do not require voter or property-owner approval but generally do not raise the substantial sums need for capital improvements).

Second, the newly heightened standard of judicial review means that care must be taken to prepare a solid engineer's report and a good record to support the decisions that a program confers special benefit and that the assessment is apportioned among properties in proportion to that benefit. Some general benefit will exist with virtually every assessment regime and must be accounted for and funded from non-assessment revenues.

Third, the proportionality requirement remains poorly defined. This case simply tells us that the engineer's report in issue did not attempt an analysis that is now required, but we are told little about what that analysis must be. Some level of judicial deference on proportionality judgments may be inevitable, notwithstanding the heightened standard of judicial review stated in this case, because line-drawing exercises are, by their nature, arbitrary at the margin. Whether a given class of property should bear 20% or 22% of the benefit and cost of a program is not a question that lends itself to a black-and-white answer; a discretionary judgment is required. If local governments exercise that discretion responsibly and develop good records to support those judgments, courts will likely uphold them.

A related case is *Dahms v. Downtown Pomona Property and Business Improvement District*, 174 Cal.App.4th 708 (2009) *review denied*, which the Supreme Court had granted review of and held pending decision of *Silicon Valley*. The Second District Court of Appeal determined the case anew in light of *Silicon Valley* and upheld the challenged assessments. The case was decided on favorable facts for the city. The business improvement district was formed after a petition from the businesses which were to pay for and benefit from the assessments and had been approved by a large margin in the assessment balloting. In addition, the attorney handling the case before the City and in the trial court did not make an especially strong record for appeal. The Court concluded that the 45-day notice period for assessment balloting excludes the day the notice is mailed (the usual rule).

More importantly, even though the assessment for security, streetscape maintenance and marketing excluded residential property and charged churches and non-profits only 5% of what others paid, the assessments were "proportional" to special benefit conferred because an agency can discount assessments for some provided that others do not pay more than the cost of the

special benefit afforded them and plaintiff had not argued that anyone was overcharged and because Article 13D, § 4(f) (which imposes the burden of proof of special benefit and proportional assessments on the agency), requires only that assessments not exceed the cost of services which specially benefit property. It does not, this Court concluded, somewhat surprisingly, also require that assessments be proportional to special benefit. By this, the Court may simply be saying some assessments can be "discounted" as compared to what others pay, but the language can be read more broadly. The Court also accepted the use of front street frontage to apportion 40% of assessment cost, ignoring side and rear frontage, because street maintenance services are more valuable at one's front door and this was not the sole factor (lot size and building size were the remaining 60% of the assessment formula). The Court concluded that special benefit is shown because these services directly benefit the assessed properties and are above the City's general level of service. It matters not that tenants and visitors also benefit from these services (and are not assessed for them) provided that the owners of the assessed parcels do not pay more than the cost of serving their properties. The court distinguished *Silicon Valley* as not involving direct services to property.

Orange County Superior Court Judge Ronald L. Bauer, sitting by designation, dissented in part, concluding that the city also bore the duty to prove proportionality by showing that discounts either reflect lesser special benefit (non-profits get less benefit from marketing) or are funded by non-assessment funds.

Because of the favorable facts and the quality of the trial court lawyering by the challenger, the case is very favorable to local governments. It may be too favorable to withstand the test of time and agencies would be wise to follow its guidance with some caution. It is good law, however, as the California Supreme Court has denied requests to depublish the case or to grant review of it.

The first case to shed any substance on the meaning of the requirement of Prop. 218 that assessment amounts be "proportional" to the special benefit conferred on assessed properties by the program of services or facilities to be funded by the assessment following *Silicon Valley* is *Town of Tiburon v. Bonander*, 180 Cal.App.4th 1057 (2009). This case arises from the same dispute discussed in paragraph 26 below. Because the ill-defined proportionality requirement also applies to property-related fees, this case is instructive in that context, too.

This case upholds a determination that a utility undergrounding district has 100% special benefit such that no portion of its construction cost need be funded from non-assessment revenues. Its significance in this regard, however, may be limited by the nature of the facility being funded – undergrounding power lines to improve views, safety and service reliability for the properties served by those lines. It also holds that a court exercising its independent judgment on review of local government assessment decisions is not confined to the record before the agency. This was a win for Tiburon in this case but may be problematic for public agencies in other cases. The case also provides a helpful, post-Prop. 218 discussion of the

distinction between general and special benefits that will assist public agencies and their assessment engineers justify assessments.

The Court upheld the finding of special benefit in this case (again, special benefit is probably more easily shown for undergrounding than most other public improvements) and allows the use of common sense reasoning to sustain a conclusion that undergrounding lines adjacent to property specially benefits that property and finds no need for expert or other evidence on the point. However, the Court rejected the Town's finding that assessments were proportional to special benefit conferred for two reasons:

First, the assessment district was divided into zones of benefit distinguished by lot sizes and hence, cost to underground power lines (the larger the lot, the longer the run of wire and the greater expense to underground it). The Court held that assessments must be apportioned according to benefit and not to costs. This is largely a rule restricting how engineers describe their reasoning rather than the reasoning itself, but is at odds with what has been common practice. Secondly, the Court found – in an independent, searching evaluation – that the Town had inappropriately excluded two cul-de-sacs at the margin of the district from the assessments for reasons it found to be inconsistent with the reasons the engineer's report gave for including two cul-de-sacs surrounded by the District.

Problematically, the Court also found that there was one "project" here, encompassing all three zones of benefit, and determined that assessments should have been equal across all three zones, even though the costs to perform the undergrounding differed greatly from zone to zone. This may be an artifact of the engineer's report's failure to provide the justification that *Silicon Valley* and this decision now demand from engineers' reports, but it may also reflect a failure to recognize that there is no objectively unassailable basis to define a project's scope. Rather, this is a legislative judgment to be reviewed (independently, of course) for failure to comply with Prop. 218's requirements of special benefit and proportional assessment. It is not something to be determined by a court in the first instance or to be reviewed more stringently than the special benefit and proportionality determinations themselves.

The case does have helpful language acknowledging that mathematical precision is not required in determining the amount of special benefit and the assessment amount proportional to the special benefit and that "some degree of imprecision" is inherent in the assessment process.

The next shoe to drop in this developing area of the law is *Beutz v. County of Riverside* (2010) 184 Cal.App.4th 1516 *pet'n rev. pending*.[19] 2010 DAR 7833 (printed 5/28). Although the County was successful in the trial court, the advent of the *Silicon Valley* decision while this appeal was pending made defending that victory more difficult. While a petition for review of

[19] The author of this paper and Sandra J. Levin of Colantuono & Levin, represent Riverside County in this case.

the case by the California Supreme Court is pending as this paper is written, the case has these core holdings:

First, the Court ruled an assessment can be defended on the basis of non-assessment revenue contributions to other aspects of the program of facilities and services and need not show that each element of a program is jointly funded by assessment and non-assessment revenues. Put more concretely, it was okay to fund all of the cost to maintain and operate parks on the assessment because other county funds were used to provide the capital facilities and thus accounted for the general benefit arising from the park program. This is a good result, although not a surprising one. Local governments have discretion to define what the program is, although the *Town of Tiburon v. Bonander* case discussed above makes it clear that courts can and will second-guess that program definition.

Second, the Court concluded that any litigation over an assessment puts in issue whether the assessment reflects special benefit and whether the assessment is proportionate to that special benefit, whether or not the petitioner exhausts administrative remedies on or pleads that issue. Any motion for summary judgment by the assessment agency requires proof on these points as they are now a mandatory part of the local government's case in chief. This results from the language of Article XIII D, § 4(f) of Prop. 218:

> In any legal action contesting the validity of any assessment, the burden shall be on the agency to demonstrate that the property or properties in question receive a special benefit over and above the benefits conferred on the public at large and that the amount of any contested assessment is proportional to and no greater than, the benefits conferred on the property or properties in question.

Thus, what most public lawyers had read as merely an assignment of the burden of proof becomes, at the hands of this court, a repeal of the requirements of administrative law that petitioners exhaust administrative remedies and plead their cases. The County has hope of reversing this conclusion via its pending petition for review.

The case also relies on *Bonander* and distinguishes *Dahms* in ways that complicate understanding of how to apportion special benefit among property owners. In particular, the court cites language from *Bonander* criticizing the use of the cost to serve a property as a measure of the benefit to that property. This is common in assessment engineers' reports and it is not clear how it might be done otherwise. If cost cannot exceed benefit, then benefit must be monetized so one compares apples to apples. How does one monetize benefit other than via cost? Must we instead look to value, perhaps fair market value for products and services for

which there is no market? This issue will remain in light of *Silicon Valley*, *Bonander* and *Dahms* whether or not *Beutz* remains in its current form and will be left for resolution in future cases.[20]

Recorded Notice of Assessment. 612 South LLC v. Laconic Limited Partnership (2010) 184 Cal.App.4th 1270 involved a dispute as to whether a buyer of commercial real estate had sufficient notice of a 1911 Act assessment to be held responsible for its payment. the Court concluded that failure to index the notice of assessment under the property owner in the county recorder's office did not invalidate the lien and that, as the statute provides, the lien is sufficiently recorded to bind future property owners when the engineer files the notice of assessment and an assessment diagram with the county surveyor and superintendent of streets (typically, the county engineer). Those notices are also recorded. The case thus involves a narrow procedural issue.

25. Assessment Legislation.

Effective January 1, 2010 is S.B. 321, carried by then-Senator (now Supervisor) Benoit (R-Riverside County) and sponsored by the Howard Jarvis Taxpayers Association. The bill makes minor changes in the assessment provisions of the Proposition 218 Omnibus Implementation Act of 1997. The measure (i) requires assessment ballots to be mailed in envelopes marked "Official Ballot Enclosed," (ii) "[i]f the agency uses agency personnel for the ballot tabulation, or if the agency contracts with a vendor for the ballot tabulation and the vendor or its affiliates participated in the research, design, engineering, public education, or promotion of the assessment, the ballots shall be unsealed and tabulated in public view at the conclusion of the hearing so as to permit all interested persons to meaningfully monitor the accuracy of the tabulation process," and (iii) requires "the information used to determine the weight of each ballot" to be treated as "disclosable public records" after the ballots are opened for tallying. The first and third points do not appear to be significant changes in the law. The second reflects wise practice in any event – tallying protests in public. The original draft of this bill also addressed the ballot secrecy issue discussed in the *Greene* case discussed under section 19 of this paper but, at the request of the League of California Cities, this section of the bill was dropped pending decision of the *Greene* case.

AB 2317 (Saldana, D-San Diego) will authorize cities and counties to collect administrative fines, as those arising in code enforcement matters, using a nuisance abatement lien or a special assessment – both mechanisms to collect enforcement fines via the property tax roll. As this paper is written, it has been approved by the Legislature and will soon be on the Governor's desk.

---

20 The fast pace of change in the area of assessment law can also be seen from a trial court decision invalidating a maintenance district in San Diego which is one of dozens of such districts relied upon by residents of that City for enhanced municipal services. Adrian Florido, "Golden Hill's Trash Cleanup and Sidewalk Sweeping in Jeopardy," **Voice of San Diego**, November 24, 2009.

26. Assessment Litigation Procedures

Bonander v. Town of Tiburon, 46 Cal.4th 646 (2009) involved a property owner's challenge to a utility-undergrounding assessment which the trial and intermediate appellate courts had rejected 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. The California Supreme Court's reversed, ruling that the language of the 1915 Assessment Act allows an ordinary lawsuit to challenge assessments under that act if filed within 30 days. Most other assessments can only be challenged by a validation suit filed and served within 60 days. While important to Tiburon, the case will be of little broader significance.[21]

In *Galbiso v. Orosi Public Utilities District*, 182 Cal.App.4th 652 (2010), the plaintiff – a member of the PUD Board – sought to challenge a sewer assessment imposed prior to her purchase of an agricultural property that was based on its land use entitlements for an 88-unit subdivision. The assessment was imposed under the Municipal Improvement Act of 1913 and, due to the plaintiff's failure to pay the assessment, the District proceeded to a tax sale, which Galbiso sued to enjoin. The trial court sustained the District's demurrer and the 5th District Court of Appeal affirmed. The Court found that Streets & Highways Code § 10400 imposed a 30-day statute of limitations on the challenge to a tax assessment, but the 60-day period for tax sales following initial assessments established by § 10405 was directory and not a statute of limitations for tax sales in subsequent years. The Court also rejected election-of-remedies and Brown Act arguments and found the District's rejection of Galbiso's request for a reassessment withstood relatively deferential judicial review as a quasi-legislative decision and upheld the trial court's refusal to allow her to amend her complaint to state a due process claim. Lastly, the Court found that the assessment was exempt from Prop. 218 as a pre-existing sewer assessment "grandfathered" by Article XIII D, § 5 finding the crucial date to be:

> "the date of levy of an assessment – which is when an assessment has legal existence – is defined by statute pursuant to section 10312, subdivision (a) as the date on which the legislative body adopts the resolution confirming the report and assessment and orders the word to be performed."

The last point is likely the most significant.

27. Fiscal Ballot Measures

The California Supreme Court recently revisited the legal standard used to evaluate whether publicly funded, election-related materials are permissible. In *Vargas v. City of Salinas*, 46 Cal.4th 1 (2009), the Court concluded Government Code § 54964, which prohibits spending

[21] The author of this paper filed and argued an *amicus* brief in the case on behalf of the League of California Cities and the California State Association of Counties.

public funds on "express advocacy" regarding a ballot measure, did not alter the rule of *Stanson v. Mott*, 17 Cal.3d 206 (1976) which requires a case-by-case analysis of the "style, tenor and timing" of a communication to determine if it is permissible informational material or prohibited campaign material.

The case involved an initiative to phase out Salinas' utility user's tax. The measure qualified for the ballot, and the City Council ordered its staff to analyze its impact. City staff concluded that, if the measure passed, the City would need to significantly cut services. A series of City Council meetings followed in which staff presented detailed, proposed program cuts, and over several weeks various departments presented slide shows describing the service reductions the City would implement if the measure passed. At these public meetings, the proponents criticized the proposed cuts and offered alternatives.

The minutes of these meetings and the slide shows and staff reports were posted on the City's web site. The City also made available at City Hall and the public library a one-page summary of the service reductions it would implement if the measure passed. The City included the same information in its quarterly newsletter.

The proponents sued, alleging that the materials were not balanced and were therefore prohibited by § 54964. The trial and appellate courts disagreed, holding that the City had not acted improperly because the materials did not expressly advocate a vote against the measure. The Court of Appeal did not consider the style, tenor or timing of the communication in reaching its decision.

The Supreme Court agreed with the result, but reaffirmed the "style, tenor, and timing" rule of *Stanson v. Mott*. The Court reasoned that if "express advocacy" were the only standard, cities could easily use public funds to issue bumper stickers and posters, for example, that did not contain express words of support for a measure, but that were nonetheless designed to promote it. Thus, the distinction between campaign activity and informational material remains the relevant inquiry. Under that standard, the Court found the City's communications were fair presentations of facts and, thus, permissible.

In light of the ruling, local governments will need to evaluate not only the content of publicly funded communications regarding ballot measures, but also their style, tenor and timing to ensure they are not prohibited campaign activity. This same test likely applies to communications regarding non-ballot measures affecting local finance, like protests of assessments and property related fees. Of course, express advocacy that is not funded with public revenues, like a privately funded "yes" campaign, remains lawful and protected by the First Amendment.

Two concurring Justices encouraged the Legislature to revisit this issue to give local governments more freedom to communicate the consequences of local fiscal measures to the electorate, so further developments in this area are likely. Indeed, the initial version of S.B. 321, discussed under section 25 of this paper above, included language regulating information

provided by local governments about assessment proposals. The author deleted that language to address concerns raised by the League of California Cities.

A similar case is *Santa Barbara County Coalition Against Automobile Subsidies v. Santa Barbara County Association of Governments*, 167 Cal.App.4th 1229 (2008), which challenged actions by a local council of governments (COG) to fund the drafting a ballot measure to impose a half-cent sales tax to fund transportation purposes. The plaintiff association alleged the COG had misspent public funds on political activity. The trial court granted the association's SLAPP motion (an expedited means to defeat "strategic lawsuits against public participation") and the Court of Appeal affirmed. The case has two important holdings from the local government perspective – first, it reaffirms the rule of many earlier cases that governments may use public funds to prepare (but not advocate approval of) ballot measures; second, it affirms that governments may bring SLAPP motions to defeat challenges to their expressive activity.

A case of tangential relevance is *DiQuisto v. County of Santa Clara*, 181 Cal.App.4th 236 (2010), in which the Court of Appeal ruled that Santa Clara County did not violate the rules of *Vargas* and *Stanson* by using public funds to negotiate with its bargaining units toward memoranda of understanding that were to include commitments by those bargaining units to refrain from supporting a ballot measure to require binding arbitration of labor disputes. The Court concluded that such bargaining was appropriate in the context of labor relations.

A.B. 9 took effect January 1, 2010 and had been introduced by Assembly Speaker John Pérez (D-Los Angeles) to require local governments to file campaign expenditure reports with the Fair Political Practices Commission only when their public education efforts regarding ballot measures stray beyond public information into express advocacy. It states that a reportable "expenditure:"

> includes the payment of public moneys by a state agency or local government agency, or by an agent of that agency, for a communication to the electorate within the jurisdiction of that agency regarding a clearly identified measure.

Reportable expenditures will:

> not include either of the following: (1) A communication where the information in the communication constitutes a fair and impartial presentation of relevant facts relating to the measure. (2) A communication otherwise required by law.

The measure seems to restate existing law and is quite similar to a regulation adopted by the FPPC in late 2008. In any event, local governments which spend more than $1,000 to provide public information about measures on the ballot are advised to file campaign expenditure reports with the FPPC – stating that the expenditures were intended to be neutral public education and not advocacy – in order to avoid second-guessing by the FPPC (in the form of penalties and fines) as to whether a particular message was "balanced and neutral" or "advocacy."

Also of interest are two new FPPC regulations that purport to restrict local government expenditures to provide public education regarding ballot measures. Regulations 18420.1 expands the definition of "independent expenditure" with respect to public agencies to import the "style, timing, tenor" standard of the *Vargas* case discussed above thus triggering a duty to report public education expenditures regarding ballot measures to the FPPC as independent expenditures. Regulation 18901.1expands the definition of "mass mailing" under the Political Reform Act's so-called "newsletter rule" to reflect the *Vargas* standard, too. Thus, agency communications regarding ballot measures can be found to violate this aspect of the Political Reform Act, too.

The League of California Cities, the California State Association of Counties, and the California School Boards Association unsuccessfully sought repeal of these regulations, arguing they exceeded the FPPC's authority under the Political Reform Act. The Commission rejected those requests and a writ action to overturn that decision is pending as this paper is written. In the meantime, local governments would be well advised to make the necessary filings with the FPPC whenever they engage in public education efforts, noting on the filings that the agency does not view its expenditures as anything other than neutral, balanced public education but that the filing is made to avoid any question as to the agency's compliance with law.

28. Lease Financing

Taxpayers for Improving Public Safety v. Schwarzenegger, 172 Cal.App.4th 749 (2009), *review denied*, upheld a decision of the Sacramento Superior Court that legislation adopted to allow lease financing of new prison facilities did not offend the debt limitation clause, Article XVI, § 1 of the State Constitution. That clause generally requires voter approval of bonded indebtedness that is not to be paid within the fiscal year in which it is incurred. There are many, somewhat technical, exceptions to this requirement, including those which apply to debts which are paid only from special funds (like utility revenue bonds) and those applicable to lease financing under which the borrowing local government is free to terminate a financing lease in any year provided that it also surrenders the right to make use of the leased asset. The Court of Appeal upheld the prison-financing statute against a facial challenge, holding:

> Those bonds may be structured in such a way that future periodic payments are contingent on future use or availability of the facilities. Hence, the state has not

undertaken an obligation that offends the pay-as-you-go principle underlying the state debt limit.

Assemblywoman Strickland (R-Ventura County) introduced A.B. 1192, drafted by the Howard Jarvis Taxpayers Association, to prohibit a local government from selling or leasing "any building to an entity that is controlled by the [local government] to raise money to fund the general expenses of the [agency]." This language reflects the bill's amendment on January 4, 2010 to narrow it to lease financing of buildings. Previous drafts would have prohibited financings in which local governments have leveraged future gas tax revenues to complete capital projects, and pledged their local street systems as security for the debt. A justification of the bill prepared by the HJTA states that it was motivated by a recent financing of the City of Oxnard along these lines. The bill died in January 2010 but may be reintroduced after the fall elections.

29. Municipal Bankruptcy

Prompted by the potential that the City of Vallejo will reject collective bargaining agreements with two of its four unions in its pending bankruptcy, Assemblyman Mendoza (D-Artesia) introduced A.B. 155 to strip local governments of their current statutory authority to file bankruptcy and require such filings to be approved by the California Debt and Investment Advisory Commission, which is comprised of state constitutional officers and legislative appointees. The measure is opposed by local government organizations and many newspaper editorial boards, but has strong union support. It was approved in the Assembly on a party-line vote and passed out of the Senate Local Government Committee on a party-line vote in early 2010 and is now pending in the Appropriations Committee. Press coverage speculated that Senator Wolk (D-Yolo) was removed from the Committee to facilitate its passage and the measure can now be expected to make it to the Governor's desk, where local government advocates hope for a veto.

On August 20, 2010 the measure was amended to add an additional option for local governments seeking protection in bankruptcy court – rather than obtain permission from CDIAC, they need only submit to an audit by the State Auditor before filing. Given the resources and other obligations of the Auditor, however, that step might greatly delay a bankruptcy filing. The bill is pending in the Senate Appropriations Committee as this paper is written.

30. Unfunded Mandates

California School Boards Ass'n v. State of California, 171 Cal.App.4th 1183 (2009) was a partial victory for local governments in the persistent tug-of-war between local governments and the State regarding the Constitution's requirement that the State pay for mandates it imposes on local government. Article XIII B, § 6 establishes this duty, and it is implemented by legislation

creating the Commission on State Mandates. That legislation excludes from reimbursement mandates approved by the State's voters, including those approved via constitutional amendments. Following amendments of the Constitution to protect transparency in government (Prop. 59) and to address school accountability measures, the Legislature adopted a statute ordering the Commission on State Mandates to reconsider earlier decisions finding reimbursable mandates under the Brown Act and with respect to the reporting of school testing results. The School Boards Association challenged the statute, arguing that it violated the mandates provision of the Constitution and the separation of powers doctrine in that the Legislature ordered an executive branch agency to reconsider an earlier, binding decision.

The Association prevailed in the trial court and on appeal, with the published appellate decision holding the Commission's decisions to implement the statute must be set aside because the legislation violated the separation of powers doctrine. However, the Court also concluded that the mandate funding requirement does not apply to actions required by ballot measures, because such mandates are not imposed by "the Legislature or any state agency," the language of Article XIII B, § 6. The Court struck down as too broad the statutory implementation of this exception to the duty to fund mandates, which disclaimed mandates "reasonably within the scope of a ballot measure." The case was then remanded to the Commission of State Mandates for redetermination in light of the decision.

Thus, while the constitutional mandates exemption is now clearly established law, it has been narrowed and the Legislature's powerlessness to order the Commission to reconsider specific mandates is now clear. The case is a win for local government.

21. <u>Changes of Government Organization</u>

Proposition 218, of course, requires property-owner or voter approval before a tax or property related fee may be "extended, imposed, or increased." Art. XIII C, § 2 (taxes); Art. XIII D, § 6(a) (property related fees). There has been some argument that when an agency changes its boundaries to include new territory (as by annexation of land or consolidation of agencies under the Cortese-Knox-Hertzberg Act, which empowers Local Agency Formation Commissions (LAFCOs)), a Proposition 218 proceeding might be required for the extension of that agency's taxes and fees into the new territory. There are no published cases on this issue, but there are some administrative decisions: 82 Ops. Calif. Att'y Gen'l 180 (1999) concluded that Proposition 218 does not apply in this context because the LAFCO protest procedure serves much the same purpose as a Proposition 218 proceeding, there was no evidence the voters who adopted Prop. 218 intended to frustrate the purposes of the LAFCO law, and it would be administratively difficult to have multiple tax and fee rates within a single agency. While this opinion has largely been found persuasive, questions arise as to whether it persuasively applies to "island annexations" to cities under Government Code § 56375.3 for which no protest proceeding is provided.

City of Fresno v. Fresno LAFCO, Fresno Superior Court Case No. 09-CECG-02832-JH, decided this issue for the City in a dispute between the City of Fresno and Fresno LAFCO, concluding LAFCO was without authority to condition island annexations on Proposition 218 compliance for the City's existing taxes and property-related fees and directing LAFCO to reconsider the matter. After LAFCO does so, further litigation from affected property owners, represented by taxpayer advocacy groups, can be expected.

Chapter 514 of the Statutes of 2009 bears some relevance to these issues: adopted by A.B. 1172 (Galgiani, D-Stockton), it provides that, upon the merger of the Eastern San Joaquin County Water District and the Central San Joaquin Water Conservation District, the merged entity may continue to impose pre-merger assessments and property-related fees collected by the previous entities "consistent with Article XIII D of the California Constitution [*i.e.,* Proposition 218]." Thus, the merged agency will have statutory power to maintain the previous fees without LAFCO consent or need for a LAFCO condition of approval of the merger to address the issue. However, Proposition 218 compliance will also be required, which may require the agency to maintain two fee structures – one applicable to the territory of each predecessor agency – unless the Attorney General's opinion noted above is found persuasive.

Conclusion

Plainly, the pace of legal developments under Propositions 13, 62, and 218 is not slowing 14 years after the approval of the latest of those measures. As always, we'll keep you posted!