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Proposition 26: New Limitations on Government Fees

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Introduction. California's law of government revenues has been dominated for a generation by initiatives – beginning with Proposition 13 in 1979, Prop 4's Gann limit the following year, Proposition 62's requirement for voter approval of county and general law city taxes in 1986, Proposition 218's limits on assessments and certain property related fees in 1996 and, most recently, Proposition 26. California voters approved this measure on November 2, 2010 to limit state and local governments' ability to fund public services via fees.[1]

In general, the measure defines as a tax requiring voter approval "any levy, charge, or exaction of any kind imposed by a local government" unless a stated exception applies. The measure is not retroactive as to local governments and therefore will affect cities, counties and special districts only when they propose to adopt a new fee or to increase an existing fee by adopting new legislation or changing an administrative "methodology" for calculating and collecting a fee. Moreover, Proposition 26 is not applicable to assessments and property related fees governed by Proposition 218 or to most land use fees. As detailed below, the measure's seven express exemptions which will cover most current fees imposed by local governments. However, the measure will have significant impacts and, as is almost always true with initiatives, there is significant uncertainty as to what the measure means and how the courts will interpret it.

Background: In 1997 the California Supreme Court decided in *Sinclair Paint Co. v. State Board of Equalization*,15 Cal.4th 866, to uphold a fee imposed on businesses that make 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 two-thirds approval of each chamber of the Legislature under Proposition 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 on society by those

[1] Although Proposition 26 has significant implications for State finance, this paper is primarily concerned with its impacts on local government.

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[2] and an air quality district's fee on new development to mitigate the impacts of that development on air quality.[3] 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 and fees on alcohol vendors to fund police services and public education efforts to address the adverse consequences of alcohol consumption.[4]

In addition, the State budget struggles of recent years led to a number of proposals in the Legislature to avoid the need for two-thirds approval of taxes, such as a proposed surcharge on vehicle license fees (VLF) to fund state parks;[5] and a 2010 action to reduce state taxes on gasoline, but to increase fees on gasoline to fund public transportation and other programs.

The framers of Proposition 26 included this statement of intent in the measure:

> Fees couched as 'regulatory' but which exceed the reasonable cost of actual regulation or are simply imposed to raise revenue for a new program and are not part of any licensing or permitting program are actually taxes and should be subject to limitations applicable to the imposition of taxes.[6]

For local governments, of course, those limitations include the requirement that a majority of voters approve taxes imposed for general government purposes (*i.e.*, the proceeds of which the City Council or Board of Supervisors has discretion to spend) and that two-thirds of voters approve special taxes, the proceeds of which are restricted to particular purposes.

The Measure. The heart of Proposition 26 as it applies to local government is an amendment to the definitions stated in Article XIII C of the California Constitution – the part of 1996's Proposition 218 governing taxes.[7] Previously, the California Constitution did not define the term "tax," but relied on court decisions to distinguish taxes from other government revenue

[2] *San Diego Gas & Elec. Co. v. San Diego County Air Pollution Control District* (1988) 203 Cal.App.3d 1132 (upholding as valid regulatory fee air pollution permit fees based on volume of pollutants emitted by permittee rather than cost of staff time devoted to issuance of permit).
[3] *California Building Industry Ass'n v. San Joaquin Valley Air Pollution Control District* (2009) 178 Cal.App.4th 120 (indirect source rule was valid regulatory fee under *Sinclair Paint* and did not impose a fee regulated by A.B. 1600 or exceed district's authority).
[4] *City of Oakland v. Superior Court* (1996) 45 Cal.App.4th 740 (pre-*Sinclair Paint* case upholding fee on liquor stores to fund city services made necessary by alcohol consumption).
[5] Proposition 21 on the November 2010 ballot was an unsuccessful proposal along these lines.
[6] Uncodified Section 1(e) of Proposition 26.
[7] All references in this paper to articles and sections are to articles and sections of the California Constitution as amended by Proposition 26 in November 2010.

measures such as assessments, fees, and fines. Proposition 26 adds a new subdivision (e) to § 1 of Article XIII C as follows:

> As used in this article, 'tax' means any levy, charge, or exaction of any kind imposed by a local government, except the following …"

The seven express exceptions to this sweeping definition are quoted and discussed below.

Proposition 26 is not Retroactive as Applied to Local Governments. An initiative measure does not have retroactive effect unless it contains an express retroactivity provision or "'it is very clear from extrinsic sources that the Legislature or the voters must have intended retroactive application.'" *Strauss v. Horton* (2009) 46 Cal.4th 364, 470 (citing *Evangelatos v. Superior Ct.* (1988) 44 Cal.3d 1188, 1209). Proposition 26 expressly applies retroactively to state measures adopted between January 1, 2010 and the measure's November 3, 2011effective date.[8] Article XIII A, § 3(c). No similar provision exists as to local levies, supporting a conclusion that Proposition 26 has no retroactive effect on local agency levies under the rule of statutory construction known by the ponderous Latin label *expressio unius est exclusio alterius* ("to say one thing is to exclude another").[9] Furthermore, the summary of the measure prepared by the Legislative Analyst states that existing fees and charges are not affected by Proposition 26 unless they are later increased or extended. Ballot Pamp., General Elec. (November 2, 2010) Analysis of Proposition 26 by Legislative Analyst, p. 58. Ballot materials are, of course, legislative history of initiative measures useful for their construction.[10]

Thus, a fee enacted prior to November 3, 2010 that does not fit within any of Proposition 26's exceptions will nonetheless remain valid provided that the legislation authorizing it is not amended so as to extend or increase the fee.

Nor should Proposition 26 require voter approval for adjustments of local levies for inflation if the formula or schedule for changes was approved before Proposition 26's effective date, although there is some debate on this point. This conclusion is based upon the definition of "increase" in the Proposition 218 Omnibus Implementation Act ("the Omnibus Act"). Government Code § 53750(h).

The Omnibus Act's definitions apply by their terms to Art. XIII C (Government Code § 53750), and thus extend to § 1(e) added by Proposition 26 unless there is plain intent to the contrary in the text or ballot materials regarding the new measure. The choice to achieve the goals of Proposition 26 by a narrow amendment of Article XIII C, without otherwise changing

[8] Constitutional amendments take effect the day after an election approving them. Article XVIII, § 4.
[9] *E.g., Arden Carmichael, Inc. v. County of Sacramento* (2001) 93 Cal.App.4th 507, review denied.
[10] *E.g., Consumer Advocacy Group, Inc. v. Exxon Mobil Corp.* (2002) 104 Cal. App. 4th 438, 445 review denied (2003).

the terms of that Article or the statutory and caselaw interpreting it, evidences intent that those other terms continue to apply. This rule of statutory construction is identified by the Latin label "*in pari materia*." *In re Wright's Estate* (1929) 98 Cal.App. 633, 635, ("[I] it is a settled rule that all statutes which relate to the same general subject-matter – briefly called statutes *in pari materia* – must be read and construed together, as one act, each referring to and supplementing the other, though they were passed at different times.") As the California Supreme Court put it:

> It is a cardinal rule of construction that words or phrases are not to be viewed in isolation; instead, each is to be read in the context of the other provisions of the constitution bearing on the same subject. The goal, of course is to harmonize all related provisions if it is reasonably possible to do so without distorting their apparent meaning, and in so doing to give effect to the scheme as a whole.

Fields v. Eu (1976) 18 Cal. 3d 322. Thus, terms used in Proposition 26are subject to the Omnibus Act's definitions. The Omnibus Act states that a:

> tax, fee, or charge is not deemed to be 'increased' by an agency action that … [adjusts] the amount of a tax or fee or charge in accordance with a schedule of adjustments, including a clearly defined formula for inflation adjustment that was adopted by the agency prior to November 6, 1996.

Government Code § 53750(h)(2)(A).

The reference to November 6, 1996 – the effective date of Proposition 218 – does not undermine our conclusion that Proposition 26 allows fee increases after that date pursuant to legislation which preceded it. The last clause of Government Code § 53750(h)'s definition of "increase" — "**including** a clearly defined formula for inflation adjustment that was adopted by the agency prior to November 6, 1996"— provides examples of what is "included" in this exception to the definition of "increase" and is not the extent of that exception. Moreover, Proposition 218 expressly applies to "increases" in property related fees on and after July 1, 1997 – the beginning of the next fiscal year after its adoption – and Proposition 26 contains no similar provision, suggesting a different outcome on this issue was intended. *Cf.* Article XIII D, § 6(d) *with* Article XIII C, § 1(e).

Accordingly, not only is Proposition 26 non-retroactive as to local government fees, it is not triggered by an increase in pre-existing fee authorized by pre-Proposition 26 legislation. Stated differently, pre-Proposition 26 fee legislation is wholly grandfathered by the measure and such legislation may continue to be implemented according to its terms without triggering Proposition 26.

Proposition 26 is Limited to Fees that are "Imposed." Proposition 26 addresses only revenue measures that are "imposed" by local government – suggesting it is limited to

circumstances in which a local agency uses its governmental authority to compel payment. Indeed, case law construing the term "impose" as used in the Mitigation Fee Act, Government Code §§ 66000-66008, commonly known as "AB 1600," makes clear that a fee is not "imposed" absent some element of force or authority:

> The phrase "to impose" is generally defined to mean to establish or apply by authority or force, as in "to impose a tax." (Webster's Third New Internat. Dict. (1970) p. 1136.)

Ponderosa Homes, Inc. v. City of San Ramon (1994) 23 Cal.App.4th 1761, 1770. Thus, voluntary arrangements, like contracts, purchases of products and services from government for which there are other providers, etc. are outside the sweep of Proposition 26.

The inclusion of the term "impose" in the fourth exception, discussed below, for fees imposed for access to or use of government property might be used to argue against this reading, as many fees for use of government property are essentially voluntary – like fees for access to recreation facilities and meeting room rental charges. However, that many government property charges are voluntary does not mean that all are. Parking meter charges enforced by tickets and towing would seem to be fees "imposed" for the use of government property within the meaning *Ponderosa Homes* gives the term.

We now turn to the seven express exceptions to Proposition 26's new definition of "tax."

Exception No. 1 for Fees for Benefit and Privileges. Article XIII C, § 1(e)(1) excludes from the new definition of "tax":

> A charge imposed for a specific **benefit conferred or privilege granted** directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of conferring the benefit or granting the privilege.[11] (Emphasis added.)

This exception should cover fees associated with **planning and police permits, franchises, preferential parking permits**, and the like provided that those fees are limited to cost of the permit program and the benefit or privilege "is not provided to those not charged."

[11] The parallel provision added to Article XIII A of the Constitution regarding the State is not identical to this language – the phrase "to the payor" is appended to the end. Its omission from Article XIII C is legally required to have some meaning – because the law assumes every word in legislation has meaning and every omitted word was omitted intentionally – but what meaning it may have is not clear. It could indicate a less demanding requirement of local governments as compared to the State that the costs of a permitting program be divided among permittees in proportion to the cost of regulating each.

If taken literally, this last phrase means that no one can be charged for a benefit or privilege if anyone gets it for free, thus prohibiting free passes for senior citizens and lower-income households. It certainly prohibits **discounts or free passes** if the cost of services to those charged less than the full price is recovered from fees imposed on others – *i.e.*, the measure prohibits cross-subsidies by which some fee payors pay more than the cost of service so others may pay less. It seems likely that discounts are permissible if funded from non-fee revenues, because the language of the exception is "those not charged" rather than "those not charged in full." Less clear is whether free passes can be subsidized with non-fee revenues while still allowing a local government to impose a fee on others. The aim of the measure is to avoid excessive fees and what harm is done to one fee payor if someone gets free service funded from taxes or other discretionary sources? This is likely to be clarified by legislation or litigation. However, there seems ample room to argue that the purposes of Proposition 26 stated in its uncodified § 1 ("Findings and Declaration of Purpose") and in the ballot arguments support a reading of Proposition 26 which allows government to reduce the burden of financing its activities for some or all beneficiaries provided that others are not overcharged.

Among the issues that arise with respect to this exception are **business improvement district assessments** under the 1989 Business Improvement District Act, which are commonly collected as surcharges on business license taxes. Such assessments are exempt from Proposition 218 because they are not imposed on property.[12] However, the Legislative Analyst's impartial analysis of Proposition 26 specifically identifies non-property-based BID assessments as potentially converted to taxes requiring voter approval by Proposition 26:

> [S]ome business assessment could be considered to be taxes because government uses the assessment revenues to improve shopping districts (such as providing parking, street lighting, increased security, and marketing), rather than providing a direct and distinct service to the business owner.[13]

Thus, a local agency should not establish a business improvement district without voter approval as a tax unless the program of services and facilities to be funded is limited to benefits provided directly to the charged businesses and not to others who are not charged. Conceivably, this could include façade improvements, marketing services, business consulting services, etc. Right-of-way maintenance, decoration of rights-of-way, and other public amenities may be more difficult to justify.

Other significant fees that may be protected in all or part by this exemption are **franchise fees** to the extent those fees are limited to the cost of providing the privilege for which the franchise issued (which may rarely be the case) and such regulatory fees as **trench cut fees** imposed on those who cut into streets to maintain water, power, cable television and telephone

[12] *Howard Jarvis Taxpayers Ass'n v. City of San Diego* (1999) 72 Cal.App.4th 230.
[13] Ballot Pamp. General Elec. (November 2, 2010) Analysis of Proposition 26 by Legislative Analyst at p. 58.

lines. Those fees, however, must be limited to cost and if a portion of the fee reflects the degradation of pavement life arising from trench cuts, a good record will be needed to prove that the local government is not recovering more than its costs.

Exception No. 2: Fees for Services or Products. Article XIII C, § 1(e)(2) exempts from Proposition 26's new definition of "tax":

> A charge imposed for a specific government **service or product** provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of providing the service or product.[14] (Emphasis added.)

This exception will cover **utility fees** not subject to Proposition 218 (such as gas, electric and wholesale water, sewer and trash fees) that are "imposed," **park and recreation fees** that are not admission or equipment rental fees (which are governed by the fourth exception discussed below), **transit fees**, **emergency response fees**, and a wide range of other government fees. This exception will apply to such inter-governmental charges as Fish & Game fees for review of CEQA documents, **booking fees** for booking City arrestees into County jails, **property tax administration fees,** etc. However, as noted above, Proposition 26 is not retroactive, so these agencies may maintain current fees, but may not increase them by legislative action – or administrative action which constitutes a change in "methodology" under Government Code § 53750(h)(2)(B) – without voter approval or demonstrating that one of the exceptions to Proposition 26 applies. As discussed in more detail below as to the fifth exception for fines and penalties, **nuisance abatement assessments** are probably best justified under this exception.[15]

Exception No. 3: Reasonable Regulatory Fees. Article XIII C, § 1(e)(3) excludes from Proposition 26's definition of "tax":

> A charge imposed for the **reasonable regulatory** costs to a local government for[16] issuing licenses and permits, performing investigations, inspections, and

[14] As is true of the first exception, there is a slight variance between Proposition 26's versions of this exception for State and local government. The phrase "to the payor" appears at the end of the State exception, but not the local government exception. The implications of this omission are the same as those discussed in footnote 11 above.

[15] The "yes" argument for Proposition 26 argues repeatedly that the measure "protects legitimate fees such as those to clean up environmental or ocean damage" and thus supports the view that nuisance abatement assessments do not violate the measure. Ballot Pamp. General Elec. (November 2, 2010), Argument in Favor of Proposition 26 at p. 60. Although the "no" campaign argued otherwise (Argument Against Proposition 26 in *id*. at 61), that argument appears to have been rejected by voters and is therefore not persuasive evidence of their intent in adopting Proposition 26 – the key issue in interpreting it.

[16] The State version of this exception uses the phrase "incident to" rather than "for." *Compare* Article XIII A, § 3(b)(3) *with* Article XIII C, § 1(e)(3). As with the differences between the State and local versions of the first two exceptions discussed at notes 11 and 14 above, the courts may have need to find meaning in this difference. It could

> audits, enforcing agricultural marketing orders,[17] and the administrative enforcement and adjudication thereof.[18] (Emphasis added.)

This exception will cover a wide range of local government regulatory fees such as **building permit fees, fire inspection fees, weed abatement assessments, alarm permit fees**, and the like. The list of permitted "reasonable regulatory costs" is a closed list (it does not say "including" or "such as") and includes: (i) issuing permits and licenses; (ii) performing investigations and audits; and (iii) administrative enforcement and adjudication. Like the first two exemptions, fees protected by this exemption are limited to the agency's reasonable costs.

There may be some question as to whether the full scope of the costs recoverable from a regulatory fee prior to the adoption of Proposition 26 may still be recovered under this language. Certainly the cost to mitigate the impacts of a regulated business by providing services to others, authorized by *Sinclair Paint*, is no longer permissible. But what of general overhead, advanced planning and other rule-making costs, and providing information to the regulated community? Do these fall within the language of the third exception? This will ultimately be a question for the courts, but it is noteworthy that the "yes" arguments in the ballot pamphlet assured voters that Proposition 26 would not prevent government from protecting the environment, cleaning up environmental damage or protecting consumers: "Proposition 26 doesn't change or undermine a single law protecting our air, ocean, waterways or forests …" Ballot Pamp., General Elec. (November 2, 2010) Rebuttal to Argument Against Proposition 26, p. 61.

Exception No. 4: Fees for Use of Government Property. Article XIII C, § 1(e)(4) provides an exception from the new definition of "tax" for:

> A charge imposed[19] for entrance to or **use of local government property**, or the purchase, rental, or lease of local government property. (Emphasis added.)

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be that "for" requires a closer relationship between an expense and the regulatory activities that follow (issuing and enforcing permits) than does "incident to."

[17] The inclusion of "agricultural marketing orders" in the local government provision of Proposition 26 appears to be in error, as those programs are operated by the State. Thus, its presence in the local government section, which the law assumes was intentional, creates interpretive puzzles.

[18] It is not entirely clear what "thereof" modifies, but we read it expansively to allow enforcement and adjudication of all of the other regulatory activities listed here – licensing, inspections, etc.

[19] The use of the word "imposed" here and in the introductory phrase of Proposition 26 defining any government levy outside a stated exemption as a tax will be used in defense of the argument that Proposition 26 is limited to situations in which government is a monopoly service provider (as of certain utility services) or interaction with it is mandatory (where a fee is imposed by ordinance or regulation) because "charges imposed" for use of government property are commonly voluntary – like entrance fees to parks, pools, theaters, parking lots, etc. However, that some fees for use of government property are voluntary does not mean that all are. *See, e.g.*, Health & Safety Code § 5471 (authorizing collection of sewer and refuse removal service charges via the tax roll). Accordingly, we find this defense unpersuasive.

Notably, this exception does not require a City to limit fees for use of its property to cost nor is it limited to real property. If a City makes personal property available for purchase or rental, it can charge whatever the market will bear (except to the extent the trailing, burden-of-proof paragraph discussed below can be read to provide otherwise). Among the fees that will be protected by this exception are: **franchise fees** for which rights to use rights-of-way or other government property are provided, like cable, gas, electric, pipeline and other franchises; and **park and recreation entrance fees and equipment rental fees** (but not fees for services, like classes, although such charges are typically voluntary and not "imposed" so as to fall within Proposition 26's definition of "tax"). It might protect **trench cut fees** from the cost-recovery limit of the first three exceptions discussed above.

This exception will allow a City to continue to set fees for use of **park and recreation facilities**, for **equipment rentals in parks**, and for **use of meeting rooms** at any price the market will bear (again, except to the extent the trailing, burden-of-proof paragraph discussed below can be read to provide otherwise). **Services provided in park and recreation programs or with respect to the use of a City's meeting spaces**, however, must now be limited to the cost of service if they are "imposed" as discussed above – *i.e.*, if some element of force or authority compels payment. This could involve lessons, massage therapy, and other park and recreation services, although we would expect most such services to be voluntary rather than "imposed" and exempt from Proposition 26 for that reason as discussed at pages 4-5 above. **Meeting space services** might include technical support, catering and the like. Again, fees for these services may rarely, if ever, be "imposed."

Conceivably a consultant's cost justification or a staff-prepared equivalent might be needed to demonstrate that new or increased fees do not recover more than the local government's cost of service.

It may be advisable to segregate revenues between those which may be used for any purpose (*i.e.*, those which are not subject to a cost-recovery limit such as admission and equipment rental fees) from those which should do no more than recover the costs of service.

Exception No. 5 for Fines and Penalties. Article XIII C, § 1(e)(5) excludes from the new definition of "tax":

> "A **fine, penalty**, or other monetary charge imposed by the judicial branch of government or a local government, as a result of a violation of law." (Emphasis added.)

"Violation of law" should be read broadly to include local ordinances, regulations and policies (like library policies for the timely return of books) and not just state statutes. "Law" generally has a broad and encompassing meaning and the framers of this measure could easily have used narrower terms like "legislation," "ordinance," and "regulation." Such more specific terms are

used elsewhere in Article XIII C.[20] "Thus, this exception will include **parking fines, administrative penalties** imposed in the code enforcement context, **late payment fees, interest charges**, and any "other monetary charge imposed by" a local government "as a result of a violation of law," defining the last term broadly.

A question arises regarding nuisance abatement assessments – *i.e.*, use of the property tax roll to recover a local government's cost to abate a nuisance on private property. These are not in the nature of fines for a violation of law, but rather cost recovery for a service. Accordingly, they are probably best justified under Article XIII C, §1(e)(2), discussed above, and limited to the reasonable cost to the local government of providing and administering the abatement services.

Helpful guidance as to what constitutes a "penalty" appears in a recent decision concluding that a penalty for understating corporate income taxes is not a "tax" within the meaning of Proposition 13. *California Taxpayers Association v. Franchise Tax Board* (2010) 190 Cal.App.4th 1139, 1148. (*Cal. Tax*) (20% penalty for late payment of corporate taxes projected to raise $1.4 billion was not a tax because it was labeled a fine, triggered by a violation of law, and its proceeds could be expected to decline over time).

Like the fourth exception, this exception makes no reference to a local government's "costs" with respect to a fine or a penalty. Nor is it clear how one would calculate costs associated with a monetary penalty, which serves to deter and punish violations of law, not to recoup government costs. No costs likely justify the $1.4 billion at stake in the *Cal. Tax* case.

Exception No. 6 for Conditions of Property Development. Article XIII C, § 1(e)(6) excludes from the definition of "tax" adopted by Proposition 26:

A charge imposed as a **condition of property development**. (Emphasis added.)

This language is, in substance, the same as the comparable exemption from Proposition 218's rules governing assessments and property related fees. Article XIII D, § 1(b) excludes from that earlier constitutional amendment "the imposition of fees or charges as a condition of property development." By its terms, this exception includes more than **development impact fees** under the Fee Mitigation Act, Government Code §§ 66000 et seq. ("A.B. 1600") and extends by its terms to any fee or charge imposed as a condition of property development, including **permit and inspection fees**, and **fees to recover the cost of advance planning services** such as a building permit surcharge to recover the cost of general and specific

[20] For example, Article XIII C, § 1(c) defines "special district" as "an agency of the state, formed pursuant to general law or a special act," and Article XIII C, § 3 refers to "the Legislature nor any local government charter."

plans applicable to a project for which a building permit is sought.[21] Of course, constitutional law (as well as the Fee Mitigation Act) limits government power to exact money and property from those who develop private property. *E.g., Nollan v. California Coastal Commission* (1987) 483 U.S. 825 (there must be a "logical nexus" between the impacts of development and the use of land or money exacted from the developer to mitigate those impacts); *Dolan v. City of Tigard* (1994) 512 U.S. 374 (an exaction must be at least roughly proportionate in amount to impacts of the development of the land from which the exaction is made).

In general, most fees imposed by the city and county building and planning departments will be exempt from Proposition 26 under this sixth exemption or under one of the first three exceptions discussed above.

Exception No. 7 for Assessments and Property-Related Fees Subject to Proposition 218. Finally, Article XIII C, § 1(e)(7) excludes from Proposition 26's new definition of "tax":

> Assessments and property-related fees imposed in accordance with the provisions of Article XIII D.

This will, of course, include **assessments on the property tax roll** and such **property-related fees** as retail (but not wholesale) fees for **water, sewer and trash** services and other property-tax-roll fees such as those imposed by some local governments for **flood control and water quality** programs.

What of assessments exempted from Proposition 218? As provided in Article XIII D, § 5, an assessment existing on the November 7, 1996 effective date of Proposition 218 imposed exclusively to finance the capital costs or maintenance and operation expenses for sidewalks and streets (*i.e.*, street landscaping and lighting assessments) need not comply with Proposition 218 until it is "increased" within the meaning of Government Code § 53750(h). *E.g., Howard Jarvis Taxpayers v. City of Riverside* (1999) 73 Cal.App.4th 679 (continued collection of landscaping and lighting assessment did not trigger Proposition 218 until the assessment was increased) ("*HJTA v. Riverside*").

We conclude that assessments grandfathered by Proposition 218 are also exempt from Proposition 26. Article XIII C, § 1(e)(7) refers to "[a]ssessments and property-related fees imposed in accordance with the provisions of Article XIII D" – it does not mention what

[21] Such advance planning cost-recovery fees can be understood as regulatory fees more likely to be covered (or not protected) by Article XIII C, § 1(e)(3), which does not plainly include rule-making in the "reasonable regulatory costs" that may be recovered. On the other hand, it is hard to know how one could issue licenses and permits and enforce regulatory regimes requiring them if one could not develop rules in the first place. And the language of the "yes" argument presented in the ballot pamphlet makes it hard to justify a narrow definition of permissible regulatory costs that would exclude rule-making, as discussed above.

provisions in particular of that article are in point – thus, in our judgment, the language encompasses the procedural and substantive requirements for assessments of Article XIII D, § 4 as well as the grandfathering exceptions stated in Article XIII D, § 5.

Voter intent supports this conclusion. In *HJTA v. Riverside*, the court determined that Proposition 218 was enacted to close a loophole in Proposition 13 by which local governments abused special assessments by imposing assessments for general governmental services. The court concluded that the exemption in § 5 of Art. XIIID was intended to carve out traditional, non-abusive, special assessments such as those for street lighting. The Findings and Declaration of Purpose section indicates that the purpose of Proposition 26 is to address the:

> "recent phenomenon whereby … local governments have disguised new taxes as 'fees' in order to extract even more revenue from California taxpayers without having to abide by [Proposition 13's and Proposition 218's] constitutional voting requirements." (Emphasis added).

Because grandfathered 1972 Act assessments are not "recent" and, under Proposition 218, cannot be increased without a mailed ballot proceeding, Proposition 26 does not appear intended to eliminate Article XIII D, § 5's protection of pre-existing 1972 Act and similar assessments. Therefore, we conclude that assessments grandfathered by Proposition 218 also fall within the exception to Proposition 26 set forth in Article XIII C, § 1(e)(7).

The Burden of Proof and the Question of Cost. The final, unnumbered paragraph of Article XIII C, §1(e) added by Proposition 26 states:

> The local government bears the burden of proving by a preponderance of the evidence that a levy, charge, or other exaction is not a tax, that the amount is not more than necessary to cover the reasonable costs of governmental activity, and that the manner in which those costs are allocated to a payor bear a fair or reasonable relationship to the payor's burdens on, or benefits received from the governmental activity.

Three points about this language bear discussion.

First, a local **government bears the burden to justify its fees** in litigation. While this is a change in the law, it may not be much of a change in how courts actually review such cases. Government had some duty to justify its revenue measures prior to Proposition 26. *E.g. Beaumont Investors, LLC v. Beaumont-Cherry Valley Water District* (1985) 165 Cal.App.3d 227 (district bore burden to produce a record on which to justify connection charge); *Home Builders Assn. of Tulare / Kings Counties, Inc. v. City of Lemoore* (2010) 185 Cal. App. 4th 554, 560-563 (discussing burden of production and persuasion in challenge to development impact fee).

Second, **the lowest standard of evidence is required** – a mere preponderance of evidence, as opposed to such higher standards as "clear and convincing evidence" or "beyond a reasonable doubt."

Finally, the last phrase introduces a concept from the *Sinclair Paint* line of cases – allocation of costs in proportion to a fee payor's benefits or burdens from government activity – that is more easily applied to assessments than to fees. It is one thing to divide the cost of a street paving project among benefitted property owners in proportion to their benefit. It is another to price a service fee based on benefit of that service to the recipient. Should water used for life-saving kidney dialysis be more expensive than water used for a flower garden? Confusion arising from this language will take some time for the courts to sort out, we fear.

The California Supreme Court's recent decision in *California Farm Bureau v. State Water Resources Control Board* (2011) 51 Cal.4th 421 is helpful on this issue. The Court stated with respect to Proposition 13:

> The question of proportionality is not measured on an individual basis. Rather, it is measured collectively, considering all rate payors.
>
> Thus, permissible fees must be related to the overall cost of the governmental regulation. They need not be finely calibrated to the precise benefit each individual fee payor might derive.

Id., at p. 438. Agencies may employ a flexible assessment of proportionality within a range of reason in setting fees. *Id*. at p. 442; *California Building Industry Assn. v. San Joaquin Valley Air Pollution Control Dist*. (2009) 178 Cal.App.4th 120, 132 (air district indirect source fee imposed on the basis of vehicle trips generated by development was not subject to Mitigation Fee Act but valid regulatory fee under *Sinclair Pain*t).

One can argue for a similar rule under Proposition 26. The goal of all initiative limitations on local government finance is to protect those who must pay for government. The cost to administer a customer-by-customer fee structure could easily outweigh any savings to customers. The Constitution need not be interpreted to require absurd outcomes at variance with the stated purposes of its provisions.

A further question arises from this phrase:

> [t]he local government bears the burden of proving by a preponderance of the evidence that … the amount [of a levy, charge or other exaction] is not more than necessary to cover the reasonable costs of governmental activity….

How do we reconcile this with the inclusion of a "reasonable cost" limitation on the first three exceptions to Proposition 26 (for fees imposed for benefits and privileges, services and products,

and for regulation) and apparently conscious omission of that requirement from the fourth and fifth exceptions (for fees for use of government property and for fines and penalties)?

The City Attorneys Department of the League of California Cities formed a Proposition 26 Ad Hoc Committee to prepare a Proposition 26 Implementation Guide to be published in early 2011. That committee did not reach consensus on this issue, but offered these competing interpretations:

1. This language merely restates the burden of production and persuasion rules outlined in the *Beaumont Cherry Valley* and *Lemoore* cases noted above, restating without changing government's duty to produce a record to justify its fees and to persuade a court that the fees are not excessive, badly apportioned or otherwise in excess of its authority. This argument strikes us as the most persuasive.

2. The three tests of this trailing paragraph (not a tax, not in excess of cost, and fair allocation) are sequential and there is no need to reach the cost test if an agency otherwise proves a fee is not a tax. We are not persuaded by this argument because proving that a particular revenue measure is not a tax will often require proof that fees do not exceed cost (as under the first three exceptions to Proposition 26, *e.g.*) and are not excessive as to any taxpayer. Accordingly, reading the second two measures of proof as applicable only when the first is not shown may lead to circular reasoning or read these last two measures out of the Constitution.

3. This language merely assigns the burden of proof to government when these tests apply, but it does not apply them where other law does not. Thus, a government bears the burden to prove that its fees do not exceed its costs when acting under the first three exceptions to Proposition 26, but not under the fourth and fifth. This interpretation is comparable to the first and we find it persuasive as well.

4. This language imports a cost-justification requirement into all seven exceptions to Proposition 26's definition of "tax" and the meaning of the exclusion of the cost limitation from the fourth and fifth exceptions (for property fees and fines and penalties, respectively) is to require a more exacting showing as to cost for the first three exceptions. We are not persuaded by this interpretation. First, we think it gives too little meaning to the apparently conscious exclusion of language regarding cost from the fourth and fifth exceptions. Second, the language used to refer to cost in the first three exceptions ("which does not exceed the reasonable costs to the local government" and "reasonable regulatory costs to a local government") is essentially the same as that used in the trailing paragraph ("the reasonable costs of the governmental activity"). How can we read the first two phrases as requiring more than the last? Does it gain more emphatic meaning from being repeated? Perhaps but, on balance, we are unpersuaded.

This question, like many that arise from initiative measures, will ultimately be resolved by the courts. It can be agreed, however, that **some** meaning must be found in the exclusion of

"cost" from the fourth and fifth exceptions to Proposition 26's new definition of "tax" under the *expressio unius* rule cited above and that nothing in Proposition 26 vitiates common law requirements regarding the justification of fees under such cases as *Beaumont-Cherry Valley* and *Lemoore*.

Summary of Impacts. In light of all this analysis, what can we determine is plainly a tax requiring voter approval as a result of Proposition 26? For now, this list is short. It includes mainly the kinds of fees authorized by the *Sinclair Paint* case, like the State's fee on lead-containing products and the alcohol impacts fees some local governments have imposed to address nuisance behaviors near alcohol vendors,[22] and the air pollution district fees cited at footnotes 2 and 3 above. It also appears to prevent legislative increases in the **Fish & Game fees** imposed on local governments to fund that agency's review of CEQA documents. And, as discussed above, it will require caution before increasing assessments imposed by 1989 Act (non-property-based) **business improvement districts**.

What's plainly a fee and not affected by Proposition 26? These include: **franchise fees** limited to cost of regulating the franchisee or for use of government property (without a cost limitation); **trench cut fees** limited to the cost to government of permitting that trench cut, which might include degradation of pavement if a record is developed to demonstrate what those costs are; and **admission fees** for government property, including many **park and recreation fees**.

Open Issues. As is typical of initiatives, and as outlined above, many questions remain to be answered. These include the impact of Proposition 26 on **in-lieu fees**. For now, it is best to view these fees as identical to other fees – *i.e.*, the mere fact that they can be avoided by some other mandatory conduct does not eliminate the need to justify them under one of Proposition 26's seven exemptions. In most cases, they will be justified as fees imposed as a condition of property development.

Other questions include whether future increases in **booking fees** can be challenged on the ground that the CHP and sheriffs are not charged to book their arrestees into County jails; whether some people can get a **free or discounted service** funded from non-fee revenues without excluding the fee from the protection of Proposition 26's exemptions for fees imposed for a benefit, privilege, service or product; and the extent to which the cost of rule-making may be recovered via a fee protected by the exemption for reasonable regulatory costs of issuing and enforcing permits and licenses.

A useful framework for considering Proposition 26 issues. In light of this discussion, questions arising under Proposition 26 can be analyzed as follows:

[22] Such fees are identified by the Legislative Analyst's impartial analysis of Proposition 26 as likely affected by it. Ballot Pamp. General Elec. (November 2, 2010) Analysis of Proposition 26 by Legislative Analyst at p. 58.

1. Was the fee in question authorized prior to the effective date of Proposition 26 – November 3, 2010 for local government and January 1, 2010 for State government? If so, the fee can be implemented without voter approval until it is "increased" by legislative action or otherwise within the meaning of Government Code § 53750(h).

2. As to post-Proposition 26 fees, was the fee "imposed" so as to bring it within the reach of Proposition 26 because some government force or authority requires payment of the fee and it is therefore not meaningfully voluntary? If not, Proposition 26 does not apply.

3. If a post-Proposition 26 fee is "imposed," do any of the seven stated exceptions apply?

4. If a post-Proposition 26 fee is "imposed" and does not fall within one of the seven stated exceptions, then Proposition 26 defines it as a "tax" for which voter approval is required under Proposition 62 (Government Code § 53720 et seq.) as to counties and general law cities and under Proposition 218 (Art. XIII C, § 2) as to all local agencies.

What ought local governments to do now? We recommend the following:

1. Local governments should not adopt a new fee or increase an existing fee without legal advice. When fees are increased, it will be useful to make a good record – perhaps by language in a resolution or staff report – of the bases of the government's conclusion that voter approval is not required and to provide factual support for that conclusion. Be aware that many fees can be justified under more than one exception and it will be best to rely on as many legal theories as are reasonably available.

2. It may be helpful to review existing fees to anticipate issues that will arise under Proposition 26.

3. If the range of uses of the proceeds of a fee changes as a result of Proposition 218 (as where a fee is legislatively increased and now requires a tighter showing that the fee does not exceed more closely defined costs) it may be helpful to segregate previous fund balances from new revenues. This can aid compliance with the spending restrictions of Proposition 26 without imposing those restrictions on funds not subject to that measure.

4. Consider whether some fee obligations can be established by agreement rather than by legislation, such as a solid waste contractor agreement rather than a solid waste hauling "franchise" adopted by ordinance.

Conclusion. As always, the law in this area will develop over time and rapid developments can be expected initially. Updated versions of this paper and the PowerPoint slides accompanying it can be found at www.cllaw.us under the "papers" link. In addition, the

League of California Cities has published a helpful "Proposition 26 Implementation Guide (April 2011), available at www.cacities.org.[23] As always, we will keep you posted!

[23] The author of this paper chaired the committee which drafted and edited the League Guide.