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A History of Local Government Revenues Under California Law: Proposition 13 Through Proposition 26

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The Golden Era of Local Legislative Discretion

Prior to the adoption of Proposition 13 in 1978, utility rate-making was governed by a body of judge-made or common law and reflected two fundamental principles that served to enhance rate-makers' discretion. First, ratemaking was understood to be a discretionary, legislative process without a single, right answer. Second, the Constitutional commitment to separation of legislative from judicial powers meant that courts reviewed rates only for fundamental unfairness or an abuse of discretion.

A modern case describes the standard as follows:

> Water rates established by the lawful rate-fixing body are presumed reasonable, fair and lawful. (*Hansen v. City of San Buenaventura* (1986) 42 Cal.3d 1172, 1180 [233 Cal.Rptr. 22, 729 P.2d 186].) A plaintiff contesting the rates bears the burden of proof of unreasonableness. (*Id*. at p. 1180; *Elliott v. City of Pacific Grove* (1975) 54 Cal.App.3d 53, 60 [126 Cal.Rptr. 371].)

Howard Jarvis Taxpayers Ass'n v. City of Los Angeles (2000) 85 Cal.App.4th 79, 82 disapproved on other grounds by *Bighorn-Desert View Water Agency v. Verjil* (2006) 39 Cal. 4th 205, 217 n.5. Earlier cases state the same deferential standard in broader terms and it was a rare case which set aside a rate as "discriminatory."

The California Supreme Court summarized the pre-Proposition 218 law in *Hansen v. City of San Buenaventura* (1986) 41 Cal.3d 1172, 1180–81 as follows:

> A city which acquires the water system of another community incurs an obligation to deal fairly with its customers in that community and to provide them with service at reasonable rates. (*County of Inyo v. Public Utilities Commission* (1980) 26 Cal.3d 154, 159, 161 Cal.Rptr. 172, 604 P.2d 566.) Rates established by the lawful rate-fixing body are presumed reasonable, fair and lawful. (*Elliott v. City of Pacific Grove* (1975) 54 Cal.App.3d 53, 59, 126 Cal.Rptr. 371; *Durant v. City of Beverly Hills* (1940) 39

> Cal.App.2d 133, 139, 102 P.2d 759.) Thus, plaintiffs bear the burden of showing that the rates fixed are unreasonable or unfair. (*Elliott*, supra, 54 Cal.App.3d at p. 60, 126 Cal.Rptr. 371.)
>
> A showing that rates lack uniformity is by itself insufficient to establish that they are unreasonable and hence unlawful. To be objectionable, discrimination must "draw an unfair line or strike an unfair balance between those in like circumstances having equal rights and privileges.... 'It is only unjust or unreasonable discrimination which renders a rate or charge unreasonable....' " (*Durant, supra*, 39 Cal.App.2d at pp. 138–139, 102 P.2d 759.) Unreasonableness will be shown where the discrimination rests solely on the nonresident status of the user. (*Inyo, supra*, 26 Cal.3d at p. 159, fn. 4, 161 Cal.Rptr. 172, 604 P.2d 566.)
>
> Reasonableness, then, is the beginning and end of the judicial inquiry. Clearly, the fact that nonresident users of public utility service are subject to a higher rate than those customers residing within city limits does not alone prove the rate unreasonable and hence invalid. Rather, nonresidents must show that the discrimination is not based on "cost of service or some other reasonable basis." (*Inyo, supra*, 26 Cal.3d at p. 159, fn. 4, italics added, 161 Cal.Rptr. 172, 604 P.2d 566; *see Durant, supra*, 39 Cal.App.2d at p. 139, 102 P.2d 759.)

Indeed, the California Supreme Court upheld Ventura's 70% surcharge on out-of-city customers, reasoning that the City was entitled to a reasonable rate of return on its investment in the utility system which served them:

> California cases indicate that utility rates need not be based purely on costs. In *Golden Gate Bridge, etc., Dist. v. Luehring* (1970) 4 Cal.App.3d 204, 84 Cal.Rptr. 291, the court stated that "the [California] Constitution does not inhibit an entity of local government from collecting fees for services it performs and using the net proceeds of enterprises such as municipal utility systems for the benefit of its own general fund." (*Id.*, at p. 215, italics added, 84 Cal.Rptr. 291.) In *Beard v. City and County of San Francisco* (1947) 79 Cal.App.2d 753, 180 P.2d 744, the Court of Appeal noted "parks, playgrounds, public utilities, and other facilities in aid of health and

> welfare of the community.... may be operated for profit." (*Id*., at p. 755, italics added, 180 P.2d 744.) Finally, according to *Dyke Water Co.* (1963) 61 Cal. P.U.C. 315, "it is for the local governing body to determine precise rates and whether the system should be subsidized or profitable." (*Id*., at p. 321, emphasis added.) Plaintiffs' contention that Ventura must provide service to nonresident customers at "cost" without an opportunity to recover a reasonable rate of return is incorrect.

Id. at 1182–83. To similar effect is *Oneto v. City of Fresno* (1982) 136 Cal.App.3d 460, 464 which upheld a provision of Fresno's charter requiring payment in lieu of taxes by water utility to general fund. Although the case construes Proposition 13's requirements, by upholding the fee on the basis that it was approved prior to the adoption of Proposition 13, it suggests that the law prior to Proposition 13 did not limit rates to the cost of service. That same court later ruled that Proposition 218 barred application of that same charter provision to water sewer and trash utilities.[1] *Howard Jarvis Taxpayers Ass'n v. City of Fresno* (2005) 127 Cal.App.4th 914.

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[1] Proposition 218 does not apply to gas and electric utilities. Art. XIII D, § 3, subd. (b). Proposition 26, however, does. Article XIII C, § 1, subd. (e). Arguably, Proposition 218 does not apply to water wholesalers who do not sell water for use at retail, given that the customers of water wholesalers are not ordinary property owners but those who opt to participate in the wholesale water market. *Apartment Ass'n of Los Angeles County, Inc. v. City of Los Angeles* (2001) 24 Cal.4th 830 (fee on residential landlords to fund housing code enforcement was not property related fee subject to Prop. 218 because landlords' participation in housing market was voluntary). However, it is plain that Proposition 26 applies to water wholesalers and retailers alike. Art. XIII C, § 1, subd. (e) ("As used in this article, 'tax' means any levy, charge, or exaction of any kind imposed by a local government, except the following … (2) a charge imposed for a specific government serve 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.")

Indeed, cases finding unlawful rate discrimination were few. One example was *Elliott v. City of Pacific Grove* (1975) 54 Cal.App.3d 53,which found a four-to-one ratio of sewer charges to properties outside the City to those inside the City to be sufficiently unreasonable that it reversed the trial court's grant of the City's demurrer, allowing the plaintiff to seek to prove discrimination. The city, of course, was also free to prove a rational basis for its rate distinction.

Thus, on the eve of the adoption of Proposition 13 in 1978, the basic rules for utility rate-making were these:

- Rates were presumed to be reasonable, fair and lawful;
- The plaintiff bore the burden to prove otherwise;
- Only unjust or unreasonable discrimination made rates "unreasonable" and subject to judicial invalidation;
- Reasonableness was the extent of a court's review of rates; and
- Rates need not be limited to cost and, under the reasoning of the *Oneto* case, could include a reasonable rate of return or a general fund transfer.

Proposition 13's Conservative Revolution

In the mid-1970s, America experienced very rapid inflation (remember Jerry Ford's "Whip Inflation Now" buttons?). Residential property prices rose rapidly and assessed valuations for property tax purposes did, too. Fixed-income seniors and others worried about losing their homes as property tax bills began to outstrip mortgage payments. The Legislature failed to craft a response and local governments did not lower property tax rates quickly enough to address the issue. This was the climate in which Los Angeles apartment investor Howard Jarvis and Sacramento conservative activist Paul Gann persuaded California voters to approve Proposition 13, "the People's

Initiative to Limit Taxation" in June 1978 by a 65% margin, winning in 56 of California's 58 counties (Yolo and Kern being the naysayers).

The primary objectives of Proposition 13 were to limit the ad valorem property tax to 1% (Article XIII A, § 1) and to require property to be assessed at full cash value in 1975–76 (*id*. § 2) or when later sold. Until a property changed hands after the effective date of Proposition 13, its assessed valuation would be limited to the change (positive or negative) in inflation, capped at 2%. *Id*., § 2, subd. (b). Given that real estate values have historically grown by more than 2% per year, this creates a disparity between the assessed valuations of properties that are sold for fair market value as compared to those which remain in the hands of earlier buyers. This is sometimes called the "welcome, stranger" assessment method, as it puts a higher burden to fund government services on newcomers to a community than on established residents.

Significant for our purposes, Proposition 13 also required two-thirds voter approval of an undefined class of "special taxes":

> Cities, counties and special districts, by a two-thirds vote of the qualified electors of such district, may impose special taxes on such district, except ad valorem taxes on real property or a transaction tax or sales tax on the sale of real property within such City, County or special district.

Cal. Const. art. 13A, § 4. Many terms used in this section are undefined, requiring clarification by litigation. Specifically, what do these terms mean: "special district," "qualified electors of such district, and "special taxes on such district"?

The adoption of Proposition 218 was viewed by the local government community as akin to Armageddon and a very broad attack on its constitutionality was promptly filed. In *Amador Valley Joint High School District v. State Board of Equalization* (1978) 22 Cal.3d 208, the then-liberal California Supreme Court exercised its original jurisdiction

to uphold the measure just three-and-half months after it was approved. The Court concluded:

1. Prop. 13 was not void for vagueness. The requirement of Article XIII A, § 1, subd. (b) that "The one percent (1%) tax to be collected by the counties and **apportioned according to law** to the districts within the counties" (emphasis added) meant according to statutory law. This gave the Legislature the power to allocate proceeds of the property tax and fundamentally changed the fiscal relationship between state and local governments. Some argue this change was very profound because it gave taxpayer and businesses little incentive to remain involved in local government elections, leaving them to be dominated by public employee unions and others. Whether or not that is so, the history of AB 8 demonstrates the significance of this choice. Consider the Education Refund Augmentation Fund (ERAF) shifts of the mid-1990s, the "triple flip" trading local sales taxes for additional property tax and the "VLF swap" trading vehicle license fees for additional property tax, and the adoption of Propositions 1A and 22 to limit State authority over local revenues.
2. Contracts clause challenges to Prop. 13 were not yet ripe, but could be adjudicated on a case-by-case basis. In fact, most such cases were resolved by finding the contracts in issue to be exempt from Proposition 13's tax limit pursuant to its exception for taxes to pay "Indebtedness approved by the voters prior to July 1, 1978." Art. 13A, § 1, subd. (b)(1).
3. The "welcome stranger" assessment system did not violate the federal Constitution's protection of equal protection or the right to travel. These points were made doubtful by the U.S. Supreme Court's decision in

Allegheny Pittsburgh Coal Co. v. County Comm'n of Webster Cty. (1988) 488 U.S. 336, which invalidated that system when applied inconsistently to disfavor the out-of-state owner of a West Virginia coal mine. However, *Nordlinger v. Hahn* (1992) 505 U.S. 1, concurred with the *Amador Valley* court in concluding that such a system uniformly applied violated neither Equal Protection nor the right to travel.

4. The provisions of Proposition 13 limiting property taxes were not so profound a change in the Constitution as to constitute a "revision" beyond the power of initiative, but reserved to proposals presented to the voters by the Legislature or a Constitutional Convention.[2]
5. Proposition 13 did not violate the requirement of our Constitution that initiatives be limited to a single subject.

Thus, Proposition 13 was approved in June 1978, upheld by the California Supreme Court against sweeping attack in September and took effect as to local taxes July 1, 1979.

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[2] A recent case argued that the requirement of Article XIII A, § 3 for two-thirds approval in each chamber of the Legislature for new taxes constituted a revision. 1. Although that claim was not foreclosed by *Amador Valley*, it seemed a belated long-shot. *Raven v. Deukmejian* (1990) 52 Cal.3d 336 (requirement of Prop. 115 that California courts construe criminal justice provisions of Constitution identically with the federal courts' construction of the U.S. Constitution was impermissible initiative revision of Constitution) liberalized the standard of review of revision claims, but the Supreme Court refused to entertain the *Young* case when it was filed in the Court's original jurisdiction, and the Los Angeles Superior Court rejected the claim, too. The Second District affirmed in an unpublished decision and the Supreme Court denied review. *Young v. Schmidt*, 2nd DCA Case No. B230629.

The Legislature provided further assistance to local government in determining what the measure required by adopting Government Code § 50076 to clarify that most user fees and regulatory fees are not special taxes subject to two-thirds voter approval. It is this statute which makes Proposition 13 directly pertinent to the current law of utility rate-making. The article in which it appears authorizes cities, counties and special districts to adopt special taxes with two-thirds voter approval. Government Code § 50075. Section 50076 provides a definition of "special tax" as follows:

> As used in this article, "special tax" shall not include any fee which does not exceed the reasonable cost of providing the service or regulatory activity for which the fee is charged and which is not levied for general revenue purposes.

The implication of this language, of course, is that a "fee which does … exceed the reasonable cost of providing the service … for which the fee is charged [or] is levied for general revenue purposes" **is** a special tax. Accordingly, the impact of Proposition 13 and Government Code § 50076 is to establish a new standard of judicial review of legislative rate-making that goes beyond "reasonableness" to reach whether the fee is limited to the "reasonable cost of providing the service" and whether it is "levied for general revenue purposes."

Proposition 13 generated ample early litigation. *County of Fresno v. Malmstrom* (1979) 94 Cal.App.3d 974 was another case filed in an appellate court's original jurisdiction to get an expedited early answer as to the implications of Proposition 13. This case was filed by Fresno County when its Tax Collector refused to place a 1913 Act assessment issued for street improvements on the tax roll, arguing it was a special tax for which Proposition 13 required two-thirds voter approval. The Court of Appeal disagreed and issued a writ to compel collection of the assessments:

> While California has never been required to consider whether statutory or constitutional limitations on general tax assessments should apply to special assessments for improvements benefiting only specific parcels of property, the handful of sister states which have interpreted such statutory or constitutional provisions have concluded that special assessments do not fall within such limitations. [Citations.] While, of course, these decisions did not involve an interpretation of the specific provisions of article XIII A, they nevertheless support a conclusion that statutory or constitutional limitations on taxes have no logical application to special assessments to finance improvements benefiting special parcels of property within the taxing jurisdiction.
>
> Therefore, we conclude that the 1 percent maximum tax limitation imposed by article XIII A on ad valorem taxes does not apply to special assessments and bonds levied pursuant to Streets and Highways Code sections 5000 et seq. and 10000 et seq., the Improvement Act of 1911 and the Municipal Improvement Act of 1913.

Id. at 982.

Next came *Kern County Water Agency v. Board of Supervisors* (1979) 96 Cal.App.3d 874. The Agency's contract with the Department of Water Resources for water supply from the State Water Project required a supplemental property tax levy to fund payments to DWR should water sales revenues be insufficient to do so. Similar language appears in all State Water Project Contractor's contracts with DWR. The County Board of Supervisors refused to place the tax on the roll for the 1979–80 fiscal year without a court declaration that voter approval was not required. The trial court issued that order, which the Court of Appeal affirmed, concluding the tax was exempt from Proposition 13 as a payment of pre-1978 voter approved debt under Article XIII A, § 1, subd. (b):

> The findings of fact by the trial court (not here challenged) show that the agency owes the department $19,452,000, of which $14,760,566 will come from collections from the local districts, leaving the amount of the tax levy

> herein involved at $4,693,290. In round figures, again, the agency pays 80 percent of its total revenue out of water charges and 20 percent out of the tax levy. A simple calculation thus shows that the agency will pay, out of the taxes herein involved, less than 25 percent of the amount the department must pay for interest and redemption charges. In every real sense, the taxes herein involved are necessary to meet the bond indebtedness approved by the voters in 1960, and reapproved by the voters of Kern County.
>
> It thus follows that the tax levy herein involved is (except for one minor item hereinafter discussed) expressly authorized by subdivision (b) of Proposition 13, which provides for "ad valorem taxes ... to pay the interest and redemption charges on any indebtedness approved by the voters prior to the time" it became effective.

Id. at 879.

The last of the cases produced in the fertile years of 1978 and 1979 is *Metropolitan Water District of Southern California v. Dorff* (1979) 98 Cal.App.3d 109, a friendly test case brought to clarify the reach of Proposition 13. Met sued its secretary to compel her to issue a certificate to confirm application of Met's pre-Prop. 13 special property tax to parcels annexed to Met and its member agency, the Calleguas Municipal Water District, even though the tax had not been approved by two-thirds of voters. Again, the Court relied on Proposition 13's exemption for voter-approved indebtedness incurred before July 1, 1978:

> The implied repeal of a statute by a later constitutional provision is not favored; in fact the presumption is against such repeal, especially where the prior statute has been generally understood and acted upon. (Citations.) "To overcome the presumption the two acts must be irreconcilable, clearly repugnant, and so inconsistent that the two cannot have concurrent operation. The courts are bound, if possible, to maintain the integrity of both (the statute and the constitutional provision) if the two may stand together." (Citations.) Article XIIIA, section one, of the

> California Constitution and section 374 of the Metropolitan Water District Act [which authorizes a property tax to fund Met services] are not inconsistent and irreconcilable so as to prevent their concurrent operation. The constitutional provision, after declaring that the maximum ad valorem tax on real property shall not exceed one percent of its full cash value (art. XIIIA, s 1(a)), goes on to state: "The limitation provided for in subdivision (a) shall not apply to ad valorem taxes or special assessments to pay the interest and redemption charges on any indebtedness approved by the voters prior to the time this section becomes effective." (Id., s 1(b).) In creating an exception to the one percent tax limitation, section 1(b) specifies only the indebtedness to which the exception is applicable; it is silent regarding the property included within the exception. At this point, section 374 steps in and provides that taxable property annexed to Metropolitan is subject to taxation for payment of authorized or outstanding obligations of Metropolitan. Thus, section 374 complements article XIIIA, section one, and effect may be given to both.

Id. at 114–15. The Court also found this principle to protect Met's tax as applied to newly annexed property, because the voters who approved Proposition 13 gave no indication they intended to interfere with either annexations or application of the usual rule that annexed property was responsible for the taxes of the annexing agency:

> That provision creates an exception to the one percent ad valorem property tax limitation for the payment of indebtedness approved by the voters before July 1, 1978, but does not state that the exception applies only to real property which was subject to taxation for the payment of such indebtedness prior to that date. " 'Courts are no more at liberty to add provisions to what is declared (in the Constitution) in definite language, than they are to disregard existing express provisions (of the Constitution).' " (*Ross v. City of Long Beach* (1944) 24 Cal.2d 258, 260, 148 P.2d 649, 650.) (Original inserts.)
>
> Section 374 of the Metropolitan Water District Act was enacted in 1969. (Stats.1969, ch. 209, s 374.) Pursuant to that statute, which embodies a well established common law principle, taxable property newly annexed to

> Metropolitan has been consistently subject to taxation for the payment of any authorized or outstanding bonds or other obligations of the district. In the absence of a more clear-cut mandate than the language of section 1(b) of article XIIIA, we may not presume that such provision abrogated the principle expressed in section 374.

Id. at 115.

And thus the initial fount of appellate guidance on the meaning of Proposition 13 for local government finance quieted for a time. Three years passed before the courts began to tackle the definitional issues noted above. 1982, however, brought three significant cases.

First was *Los Angeles County Transportation Comm'n v. Richmond* (1982) 31 Cal.3d 197, which found that a transactions and use tax ("sales tax") created by the County Transportation Commission was not a "special tax" for which Article XIII A, § 4 requires two-thirds approval. Justice Mosk wrote for a three-judge plurality, concluding the LACTC was not a "special district" within the meaning of Proposition 13 because it never had the power to impose a property tax and therefore could not have been within the intended reach of Proposition 13's special tax provision, which was intended to prevent agencies which lost property taxes under Proposition 13 from replacing them with other taxes without two-thirds voter approval. *Id*. at 206. Justice Kaus separately concurred for himself and Justice Newman on this point and it therefore represents a 5-justice majority opinion. *Id*. at 209. Justice Mosk's plurality, however, also provided a standard of review of disputes regarding the sweep of the two-thirds vote requirement which Justices Kaus and Newman did not join and, in light of subsequent judicial and legal history, seems almost quaint:

> In view of the fundamentally undemocratic nature of the requirement for an extraordinary majority and the matters discussed above, the language of section 4 must be strictly construed and ambiguities resolved in favor of

> permitting voters of cities, counties and "special districts" to enact "special taxes" by a majority rather than a two-thirds vote.

Id. at 205. Justice Richardson dissented, predicting (accurately, it can be argued) that this decision created a loophole through which many non-voter approved taxes might pass. He argued that, under the decision, the Legislature could create new statutory agencies, deny them the power to impose property taxes, and allow them to impose "general taxes" to accomplish specific purposes without voter approval. *Id*. at 213. Justice Mosk rejected the claim, noting that LACTC was created two years before Proposition 13 was approved. *Id*. at 205. Justice Richardson would win this argument, of course, after Justices Byrd, Reynoso and Grodin were denied retention in the November 1986 election and the subsequent appointment of a far more conservative Court by Governor Deukmejian. *Rider v. County of San Diego* (1991) 1 Cal.4th 1 [San Diego County Regional Justice Facility Financing Agency was a "special district" and its ½-cent sales tax was a "special" tax requiring two-thirds voter approval; overruling *Richmond*].

The second consequential decision involving Proposition 13 of 1982 was *Carman v. Alvord* (1982) 31 Cal.3d 318, which found that a supplemental property tax to fund San Gabriel's voter-approved participation in PERS' pension programs was also exempt from Proposition 13 as pre-1978 voter-approved debt. Doing so allowed the Court to avoid the impairment of contracts issues it had found unripe in *Amador Valley* in 1978:

> We need not decide here how the contract clause might apply to hypothesized facts. (*See, e.g., Amador Valley, supra*, 22 Cal.3d 208, 240–241.) Rather we adopt a reasonable interpretation of subdivision (b) that "avoids the constitutional issue inherent in a contrary construction." [Citation.] We conclude that subdivision (b) exempts from the article XIII A tax limitation the voter-approved tax to fund City's pension commitments.

Id. at 332–33. The Court viewed this expansively, writing in a footnote:

> It might be argued that contract clause problems do not arise as to employees hired after the effective date of article XIII A, since they perhaps did not enter service in reliance on City's power to levy the special tax. Yet we see no reason to carve an exception for such persons. We may not assume that subdivision (b) sought to force local governments to the complex calculations necessary to separate their obligations to pre- and post-1978 employees. Article XIII A exempts "interest and redemption charges on any indebtedness previously approved by the electors." San Gabriel's voters in 1948 obviously understood that subsequently hired employees too would be covered.

Id. at 333, n. 11. Current law, however, requires precisely such calculations. *Howard Jarvis Taxpayers Ass'n v. County of Orange* (2003) 110 Cal.App.4th 1375 [Huntington Beach supplemental property tax for PERS benefits limited to cost of benefits negotiated prior to July 1, 1978]. The *Carman* Court also concluded that what was protected by Article XIII A, § 1, subd. (b) as a tax to pay pre-1978 voter-approved debt was not subject to § 4's requirement for two-thirds voter approval:

> Even if City's pension levy is a "special tax" on real property, section 4 cannot be construed to preclude taxes that section 1, subdivision (b), exempts from the constitutional ceiling; i.e., those necessary to pay "interest and redemption charges on any indebtedness [previously] approved by the voters." Since subdivision (b) of section 1 exempts City's property levy for pensions, section 4 does not proscribe it.

Carman v. Alvord, supra, 31 Cal.3d. at 334.

Finally, 1982 brought *City & County of San Francisco v. Farrell* (1982) 32 Cal.3d 47, which tackled the meaning of "special tax" as used in Article XIII A, § 4. Applying the standard of review articulated in *Richmond* to construe the two-thirds voter-approval requirement of Proposition 13 narrowly, the Court concluded that San Francisco's gross receipts and payroll taxes on business were not special taxes because they were placed

in the City's general fund and used to fund all city services. The case was test litigation filed by the City against its own controller to test the validity of a tax approved by a simple majority of the City electorate. The Court rejected Farrell's argument for a broad reading of "special tax":

> Farrell's claim that the word "special" as used in section 4 means "additional" or "extra" or "supplemental" effectively reads the word "special" out of the statute, since any taxes imposed by a local entity following adoption of article XIII A would be encompassed within those descriptive terms. Moreover, the language used in section 3 of the article … indicates that the term "special taxes" in section 4 refers to some particular type of tax. Section 3 provides that state taxes enacted for the purpose of increasing revenue must be passed by a two-thirds vote of each house of the Legislature. The section states that "any" changes in state taxes to increase revenue must be enacted by the two-thirds vote. If the term "special" were to have the broad meaning suggested by Farrell, it is very likely that section 4, like section 3, would have provided that "any" changes in taxes would require the votes of an extraordinary majority. Thus, the language of section 4 appears to support the city's assertion that "special taxes" refers to a particular type of tax rather than to any and all exactions.

Id. at 54. The Court's majority concluded:

> In keeping with these principles, we construe the term "special taxes" in section 4 to mean taxes which are levied for a specific purpose rather than, as in the present case, a levy placed in the general fund to be utilized for general governmental purposes. This is a common meaning of the term, as is evident from the authorities cited above. More important, such a construction will provide the voters with the "effective" property tax relief we discussed in *Amador* to the extent the section clearly requires a two-thirds vote for the adoption of a "special tax," while ascribing some meaning to every word used in the section. (*See Los Angeles County Transportation Com. v. Richmond, supra*, 31 Cal.3d 197, 208.)

Id. at 57. Justice Kaus dissenting, arguing for a different rule of decision:

> As the various opinions in this case make clear, the terms of Proposition 13 itself provide no hint of what the drafters of the initiative had in mind when they used the term "special taxes" in article XIII A, section 4. As I noted in my separate opinion in *Los Angeles County Transportation Com. v. Richmond* (1982) 31 Cal.3d 197, 208-209 [182 Cal.Rptr. 324, 643 P.2d 941], however, "the description and discussion of [section 4] in the election pamphlet which was before the voters suggest to me that the purpose of this section was simply to limit the authority of a city, county or special district to impose new 'special taxes' *to replace property tax revenue* that the city, county or special district lost as a result of the other portions of Proposition 13." (Orig. italics.)

Id. at 58. Only conservative Justice Richardson argued for Farrell's approach. *Id*. at 57–58. On this one, history favored the Byrd Court majority, as the "special purpose" rule for special taxes was adopted by Proposition 62 in 1986. Government Code § 53721 ("Special taxes are taxes imposed for specific purposes"). Proposition 218 elevated this definition, along with *Rider's* gloss on it, to our Constitution. Article XIII C, § 1, subd. (d) states: "'Special tax'" means any tax imposed for specific purposes including taxes imposed for specific purposes which are placed into a general fund." A pre-election annotation of Proposition 218 circulated by the Howard Jarvis Taxpayers Association, one of its drafters, states:

> Annotation: This reinforces language of Rider v. San Diego dealing with special taxes. The key is the purpose of the funding not the name of the bank account."[3]

With many basic questions settled about the constitutionality of Proposition 13, the meaning of "special district" and "special tax," and given the utility of the exemption of Article XIII A, § 1, subd. (b)'s exemption for pre-1978 debt to avoid impairment-of-contract claims and other problems; it would be another 9 years before Proposition 13 litigation produced significant appellate authority.

As mentioned above, in 1992 the U.S. Supreme Court rejected challenges to the "welcome stranger" apportionment approach of Proposition 13 in *Nordlinger v. Hahn* (1992) 505 U.S. 1, concluding that consistent enforcement of such a method violated neither equal protection nor the right to travel.

Brydon v. East Bay Municipal Utility District (1994) 24 Cal.App.4th 178 affirmed tiered conservation water rates over a challenge brought by residents of the hotter, dryer, interior portions of the District. The court concluded that the District was not a "special district" the taxes of which require two-thirds voter approval under Article XIII A, § 4 because it predated Proposition 13 and was not empowered to impose a property tax. The court also concluded that the conservation rates were not special taxes because: (i) state law mandates water conservation, (ii) the rates were not intended to replace property taxes reduced by Proposition 13, and (iii) customers could avoid

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[3] Right of Vote on Taxes Act (Proposition 218) Annotated as of September 5, 1995 by the Howard Jarvis Taxpayers Ass'n, reprinted at page A-17 of the League of California Cities, **Proposition 218 Implementation Guide** (2000 ed.)

penalty rates by conserving water. It also concluded the challengers had failed to show the rates were arbitrary and capricious. The court noted that the applicable standard of review was the arbitrary and capricious standard of review of quasi-legislative actions and, in a holding cited with approval by the Supreme Court in *California Farm Bureau v. State Water Resources Control Board* (2011) 51 Cal.4th 421, 438, found that a rate need not be proportionate to the cost of serving every ratepayer to avoid characterization as a special tax under Proposition 13. As we will see in our discussion of Propositions 218 and 26 below, however, this may not be the case under those measures. The latest discussion of conservation rates appears in *Palmdale v. Palmdale Water District* (2011) 198 Cal.App.4th 926, a Proposition 218 case also discussed below.

Ventura Group Ventures, Inc. v. Ventura Port District (2001) 24 Cal.4th 1089 involved the effort of a judgment creditor to compel the District to assess a tax to fund payment of the judgment. The District observed, accurately, that it lacked the power to do so under Proposition 13. The Court of Appeal rejected the judgment creditor's argument that the Proposition 13 violated the Republican Form of Government Clause of the federal Constitution[4] and that its application in this case effected a taking.

Allocation of Property Taxes Under Prop. 13

The state had a surplus of billions of dollars when Proposition 13 punched a billion-dollar hole in the finances of local governments. Article XIII A, § 1, subd. (a) provided that the proceeds of the newly reduced property tax should be "apportioned

[4] This clause of Article IV, § 4 of the U.S. Constitution states: "The United States shall guarantee to every State in this Union a Republican Form of Government …."

according to law to the districts within the counties." The California Supreme Court, in turn, decided that "according to law" meant "according to statute." *Amador Valley, supra*, 22 Cal. 3d at 258–59.

Using this authority, the Legislature first provided, in 1978, that property taxes would be allocated in proportion to the allocation of property taxes in the fiscal year prior to the adoption of Proposition 13 in June 1978. Government Code § 26912. Thus, it apportioned the reduced property tax just as the larger, pre-Proposition 13 tax had been apportioned as a result of the decisions of the various local governments to exercise their powers to set property taxes.

With the adoption of A.B. 8 in 1979, however, the Legislature reduced property taxes flowing to education (*i.e.*, K-12 school districts and community college districts) for the benefit of cities, counties and non-education special districts and backfilling education (which the State has an obligation to fund under *Serrano v. Priest* (1976) 18 Cal.3d 728, which invalidated our previous system of school finance as violating equal protection by providing more revenues to school districts serving wealthy areas as compared to those serving areas with less wealth). The net effect of A.B. 8 was to "bail out" local government with the State's surplus using the State's new control over property tax allocations as the mechanism. A.B. 8 relied on property tax allocations in the three fiscal years prior to the adoption of Proposition 13.

In *City of Rancho Cucamonga v. Macksum* (1991) 228 Cal.App.3d 929 no- and low-property tax cities and their residents challenged the A.B. 8 formula. Cities which did not levy a property tax in the three fiscal years prior to the adoption of Proposition 13 in 1978, including subsequently incorporated cities which did not exist in 1978, received no share of property taxes under the A.B. 8 formula. The Court of Appeal rejected a range of constitutional challenges in the case, finding that A.B. 8 does not violate the tax

situs rule of Article XIII A, § 1; the pre-Proposition 13 requirement of Article XIII, § 1 that assessment be uniform; the prohibition on the imposition of a state tax for local purposes of Article XIII, § 24, subd. (b); the home rule power of charter cities conferred by Article XI, § 5; or the equal protection rights of the cities' residents.

The complaints of no- and low-property tax cities were partially addressed by statute in 1994 with the adoption of the Tax Equity Act, Revenue & Taxation Code § 98 et seq., which provides a minimum property tax share to cities at county expense.

In the early 1990s, the state and national economies fell into recession and California was hurt especially hard by the shrinkage of the defense and aerospace industries following the collapse of the Soviet Union. The Legislature sought to solve its budget problems partly at local expense by enacting the Educational Revenue Augmentation Fund, or ERAF, shifts of 1992–93 and 1993–94. Revenue & Taxation Code § 97 et seq. These statutes essentially reversed A.B. 8, restoring the pre-1979 allocation of property taxes and shifting millions of dollars from cities, counties and non-education special districts to schools for the benefit of the state. This led, as it must, to litigation and provided the next occasion for case developments under Proposition 13.

Challenges to the allocation of property taxes following the ERAF shifts met the same result — the Courts give substantial deference to the Legislature's power to allocate property taxes under Proposition 13. *San Miguel Consolidated Fire Protection Dist. v. Davis* (1996) 25 Cal.App.4th 134 rejected a fire district's challenge to the ERAF shift, concluding that residents, but not districts, had standing to challenge the ERAF shifts; that the statute was not void as unduly vague; the statute was authorized by Proposition 13; and an exception for small fire districts did not violate equal protection.

This experience with the Legislature's power to allocate property taxes led to the adoption of Prop. 1A in 2004 to amend Article XI, § 25.5. Disappointment with that

measure led to the 2010 adoption of Prop. 22 to further amend Article XI, §§ 24 and 25.5 to limit the Legislature's power to reallocate property taxes and other local government revenues to accomplish state fiscal objectives.

Proposition 218: The Right to Vote on Taxes Act[5]

The next major development in the California law of utility rate-making was 1996's Proposition 218, the so-called "Right to Vote on Taxes Act," which added Articles XII C and D to our Constitution. While it is not the purpose of this paper to provide a detailed analysis of the intent and effect of that measure, a brief summary of its major provisions follows. As to **taxes** and **initiatives**:

- Majority voter approval is required for all general taxes of cities, counties and special districts. Article XIII C, § 2, subd. (b).[6]
- General taxes must be placed on general election ballots in which legislative seats are contested unless the legislative body unanimously declares an "emergency." Article XIII C, § 2, subd. (b).
- Special taxes require two-thirds voter approval. *Id*, subd. (d).

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[5] 1986 brought adoption of Proposition 62, a statutory initiative to require voter approval of local taxes Government Code § 53720 et seq. Because all the essential requirements of that measure are duplicated by Article XIII C, adopted by Proposition 218, this paper does not address that earlier measure.

[6] Article XIII C, § 2, subd. (a) states that "special purposes districts … shall have no power to levy general taxes." This might or might not refer to the "special districts" defined in Article XIII C, § 1, subd. (c). *Pajaro Valley Water Management District v. AmRhein* (2007) 150 Cal.App.4th 1364, 1378 n. 10 ("This use of the term 'special purpose district' illustrates the questionable draftsmanship that pervades the measure, for while it contains a definition for 'special district' (Art. 13C, § 1, subd. (c)), it does not define the phrase 'special purpose district.'"

- The initiative power is extended so that initiatives may "affect local taxes, assessments fees and charges." Article XIII C, § 3.

The measure also provides a closed list of allowed imposts on property. Taxes, assessments, and property related fees are limited to:

- The 1% tax permitted by Article XIII A, § 1 (Prop. 13);
- Special taxes approved by two-thirds of voters pursuant to Article XIII A, § 4 (Prop. 13);
- Assessments imposed consistently with Proposition 218, Article XIII D, §§ 4 and 5.
- Property related fees imposed consistently with Proposition 218, Article XIII D, § 6.

Assessments are subject to a host of new procedural and substantive requirements, including:

- Strict new rules are imposed with respect to the determination of special benefit to assessed property necessary to justify assessment funding of a program of facilities or services, Article XIII D, § 4, subd. (a);
- Public agency property cannot be excluded from the allocation of assessment in proportion to special benefit, *id*.;
- Assessments must "be supported by a detailed engineer's report prepared by a registered professional engineer," Article XIII D, § 4, subd. (b);
- Assessments must be approved by property owners in a mailed-ballot proceeding in which ballots are weighted by the amount of assessment the property owner is to pay, Article XIII D, § 4, subd. (c) – (e).

Some assessments existing in November 1996 are exempt from Proposition 218's requirements until they are "increased", as that term is defined in Government Code § 53750, subd. (h):

- "Any assessment imposed exclusively to finance the capital costs or maintenance and operation expenses for sidewalks, streets, sewers, water, flood control, drainage systems or vector control."
- "Any assessment imposed pursuant to a petition signed by the persons owning all of the parcels subject to the assessment at the time the assessment is initially imposed."
- "Any assessment the proceeds of which are exclusively used to repay bonded indebtedness of which the failure to pay would violate the Contract Impairment Clause of the Constitution of the United States."
- "Any assessment which previously received majority voter approval from the voters voting in an election on the issue of the assessment."

Article XIII D, § 5.

Finally, a new class of **property related fees** is defined and subjected to a number of limits:

> "Fee" or "charge" means any levy other than an ad valorem tax, a special tax, or an assessment, imposed by an agency upon a parcel or upon a person as an incident of property ownership, including a user fee or charge for a property related service. Article XIII D, § 2, subd. (e).

"Property ownership" and "property related service" are also defined:

> "Property ownership" shall be deemed to include tenancies of real property where tenants are directly liable to pay the assessment, fee, or charge in question.

> "Property-related service" means a public service having a direct relationship to property ownership.

Article XIII D, § 2, subds. (g), (h). Article XIII D, § 6, subd. (b)(5) also states:

> Reliance by an agency on any parcel map, including, but not limited to, an assessor's parcel map, may be considered a significant factor in determining whether a fee or charge is imposed as an incident of property ownership for purposes of this article.

Fees in this new class are subject to both procedural and substantive rules, some drawn from earlier law, some entirely new. The **procedural** highlights are these:

- An agency must give 45 days' mailed notice to affected property owners of a public hearing on a proposed fee or fee increase. Article XIII D, § 6, subd. (a)(1).
- If a majority of affected property owners protest a fee, in writing, before the end of the hearing, the fee may not be imposed. *Id*., subd. (a)(2).
- "Except for fees or charges for sewer, water, and refuse collection services" an election must also be held at least 45 days after the public hearing. The agency may choose whether to seek majority approval of property owners (apparently voting one parcel, one vote) or a two-thirds vote of registered voters. Article XIII D, § 6, subd. (c). The agency may adopt rules to govern elections comparable to those required by Article XIII D, § 4 for assessments. *Id*.; see also *Greene v. Marin Co. Flood Control & Water Cons. Dist*. (2010) 49 Cal.4th 277 (§ 6(c) election on flood control fee not subject to ballot secrecy requirement of Article II, § 7).

Proposition 218's **substantive** requirements for property-related fees are:

> "(1) Revenues derived from the fee or charge shall not exceed the funds required to provide the property related service.

> (2) Revenues derived from the fee or charge shall not be used for any purpose other than that for which the fee or charge was imposed.
>
> (3) The amount of a fee or charge imposed upon any parcel or person as an incident of property ownership shall not exceed the proportional cost of the service attributable to the parcel.
>
> (4) No fee or charge may be imposed for a service unless that service is actually used by, or immediately available to, the owner of the property in question. Fees or charges based on potential or future use of a service are not permitted. Standby charges, whether characterized as charges or assessments, shall be classified as assessments and shall not be imposed without compliance with Section 4 [of Article XIII D].
>
> (5) No fee or charge may be imposed for general governmental services including, but not limited to, police, fire, ambulance or library services, where the service is available to the public at large in substantially the same manner as it is to property owners."

Article XIII D, § 6, subd. (b).

Proposition 218 Litigation

While the tax provisions of Proposition 218 largely duplicate those of Propositions 13 and 62 (adopted as a statutory initiative in 1986 as Government Code §§ 53720 et seq.), the assessment and fee provisions were entirely new. The Proposition 218 Omnibus Implementation Act of 1997, adopted as consensus legislation with support from both taxpayers and local governments, provided meaningful guidance as to assessments, but was nearly silent as to fees until after decision in *Bighorn-Desert View Water Agency v. Verjil* (2006) 39 Cal.4th 205. Much of the work in fleshing out the meaning of Proposition 218 was left to litigation and case law. To that we now turn, with our presentation divided as between assessment and fee litigation, with each discussion chronological.

I. **Assessment Litigation**

The first round of assessment litigation involved definitional issues — what assessments were subject to Proposition 218 and which qualified for the grand-fathering exceptions of Article XIII D, § 5. *Howard Jarvis Taxpayers Ass'n v. City of San Diego* (1999) 72 Cal.App.4th 230 interpreted Proposition 218's assessment provisions as limited to assessments on property. Non-property-based assessments, such as those on businesses in non-property-business improvement districts, were not subject to the measure.[7] *Howard Jarvis Taxpayers Ass'n v. City of Riverside* (1999) 73 Cal.App.4th 679 concluded that Riverside's street-lighting assessments under the 1972 Landscaping and Lighting Act were exempt under Article XIII D, § 5 as "street" assessments and the lighting power bill was an allowable "maintenance" cost.

2002 brought *Not About Water Committee v. Board of Supervisors* (2002) 95 Cal.App.4th 982. This was a very favorable decision to local government, applying pre-Proposition 218 law to the determination of what special benefit need be shown to justify an assessment and what level of judicial scrutiny would be brought to bear on special benefit and proportionality determinations. These aspects of the case are no longer good law under the *Silicon Valley* case discussed immediately below. However, another holding has withstood the test of time: The weighted vote procedure of Article XIII D, § 4 does not offend equal protection even if large agricultural water customers can outvote more numerous residential customers who pay less of the assessment cost.

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[7] Proposition 26, adopted in 2010 as Article XIII C, § 1, subd. (e), has implications for such assessments, however.

By far the most significant case involving Proposition 218 assessments is *Silicon Valley Taxpayers Ass'n v. Santa Clara Co. Open Space Authority* (2008) 44 Cal.4th 431. This case has spawned an industry of assessment litigation. It did so by rejecting *Not About Water*'s reliance on pre-Proposition 218 case law with respect the standard of judicial review of quasi-legislative findings that a particular assessment program provides special benefit to property and that assessment amounts are proportionate to the special benefit conferred on each property owner. Under *Silicon Valley*, these determinations are now subject to independent judicial review as "constitutional facts," the existence of which cannot be left in legislative hands without eviscerating the constitutional right in issue. Because this standard is relatively new, case law is rapidly developing to help frame what must be shown to demonstrate "special benefit," which Proposition 218 defines as:

> "Special benefit" means a particular and distinct benefit over and above general benefits conferred on real property located in the district or to the public at large. General enhancement of property value does not constitute "special benefit."

Article XIII D, § 2, subd. (i). We do not yet have much guidance as to what will be required to show proportionality of assessment amounts to special benefit.

The first case post-*Silicon Valley* was quite deferential to the assessing local government. *Dahms v. Downtown Pomona Property & Business Improvement District* (2009) 174 Cal.App.4th 708 was a pro. per. challenge to a PBID for which downtown Pomona businesses petitioned and which they approved by a large margin. These favorable equities may explain the decision's acceptance of the City's formula for apportioning assessments among properties, its limited assessment of non-profits, and its conclusion that supplemental municipal services necessarily provided special benefit to property

even where the services in issue (street-cleaning, supplemental security, etc.) would seem to benefit tenants and visitors as well as property owners.

More recent cases have been more demanding of assessing agencies. *Town of Tiburon v. Bonander* (2009) 180 Cal.App.4th 1057 helpfully found that a utility undergrounding assessment had no general benefit and all of its costs might be charged to property owners. However, the court invalidated the assessment because the Court concluded the City had drawn assessment district boundaries improperly.

Beutz v. County of Riverside (2010) 184 Cal.App.4th 1516 invalidated a landscaping and lighting assessment for park maintenance. The Court did allow the County to treat its capital contribution to park acquisition as non-assessment funding of the parks program so that the park maintenance cost could be entirely funded by the assessment even though the park program conferred general as well as special benefits (as almost all assessment programs do). However, the Court ruled that the defendant local government always bears the burden to prove special benefit to property and proportionality of assessments amounts to special benefit even where a plaintiff fails to exhaust administrative remedies on these issues. The Court concluded the respondent agency had not sufficiently demonstrated the assessments in question to be proportionate to special benefit and invalidated them. In particular, the assessments did not vary by distance of assessed properties from the parks to be improved and maintained under the assessment program.

Golden Hill Neighborhood Ass'n v. City of San Diego (2011) 199 Cal.App.4th 416 invalidated a charter city's assessment for supplemental municipal services because the City failed to make an adequate record of the basis on which it identified special benefit to its own properties such that it could vote for the assessment in the protest proceeding

required by Article XIII D, § 4. However, the decision provides a helpful discussion of how proportionality **can** be demonstrated.[8]

2. Proposition 218 Fee Litigation

Like most initiatives, Proposition 218 is poorly drafted.[9] It fails to define many of its terms and what definitions it provides are not always helpful.[10] Negotiation of the Proposition 218 Omnibus Implementation Act of 1996, Government Code § 53750 et seq., reflected a wide consensus of local government and taxpayer advocates and therefore provided essentially no guidance for construction of Article XIII D, § 6 governing property related fees, as to which no consensus was possible. Neither local government nor taxpayer advocates saw reason to compromise on the meaning of that section, as each preferred to litigate for a whole loaf than to settle for a half.

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[8] The California Supreme Court's 2011 grant of review in *Concerned Citizens for Responsible Government v. West Point Fire Protection District*, Case No. S195152, had been expected to provide guidance on the special benefit and proportionality requirements of Article XIII D, § 4. However, the Court dismissed the case as moot and declined a request to republish the problematic decision of the Third District Court of Appeal in the dispute. Accordingly, clarification of these issues will await a future case.

[9] The 6th District Court of Appeal has observed as much: "This use [in Art. XIII C, § 2, subd. (a)] of the term "special purpose district" illustrates the questionable draftsmanship that pervades the measure, for while it contains a definition for "special district" (Art. 13C, § 1, subd. (c)), it does not define the phrase "special purpose district." *Pajaro Valley Water Mgmt. Agency v. AmRhein* (2007) 150 Cal. App. 4th 1364, 1378 n. 10.

[10] For example, the measure defines "property related service" in somewhat circular fashion as "a public service having a direct relationship to property ownership." Article XIII D, § 2, subd. (h).

Initially, this provided a good bet for local government, which avoided application of Proposition 218 to utility fees for a decade. In 2001, the California Supreme Court decided its first major case involving fees under Proposition 218 and construed the measure narrowly. Writing for a five-member majority, Justice Mosk concluded that a fee the City of Los Angeles imposed on multi-family residential property to fund Housing Code and slum abatement programs was not imposed "as an incident of property ownership" so as to fall within the definition of property related fee stated in Article XIII D, § 2, subd. (e). *Apartment Ass'n of Los Angeles County, Inc. v. City of Los Angeles* (2001) 24 Cal.4th 830. Rather, Justice Mosk concluded, the fee was triggered by the voluntary decision of a landlord to enter the regulated business of multi-family rental housing and the fee was therefore not imposed on the basis of property ownership alone. Although the case remains good law, its sweep has been significantly narrowed by later decisions.

An earlier decision, *Howard Jarvis Taxpayers Ass'n. v. City of Los Angeles* (2000) 85 Cal.App.4th 79 had held that fees for metered water consumption were not subject to Proposition 218 for similar reasons — these were not imposed on property ownership alone, but on the decision to use a particular volume of water. The case seemed to ignore this element of Proposition 218's definition of "property related fee" — "Including a user fee or charge for a property related service" — and the partial exclusion of water fees from the election requirement of Article XIII D, § 6, subd (c). If

metered water fees were not property related fees at all, why exclude them from the election requirement of this section?[11]

Based on these two rulings, most public lawyers took the position that Article XIII D, § 6 did not apply to ordinary utility charges based on measured consumption. While most maintained this position until 2006, there were a few earlier straws in the wind that this position might not hold. First was *Howard Jarvis Taxpayers Ass'n v. Roseville* (2002) 97 Cal.App.4th 637, in which the 3rd District held that a franchise fee imposed on city utilities for the benefit of its general fund violated Article XIII D, § 6, subd. (b)(2) because there was no cost justification for the portion of utility fees not used for utility purposes. This court viewed utility charges as subject to Proposition 218, but expressly invited local governments that wished to maintain general fund transfers to provide cost justification for them.

Howard Jarvis Taxpayers Ass'n v. City of Salinas (2002) 98 Cal.App.4th 1351[12] held that a fee imposed on property in proportion to its impervious coverage — *i.e.*, paving and other hardscape that generates runoff — to fund water quality and flood control programs was a property related fee within the reach of Article XIII D, § 6. It also concluded that the water quality and flood control program was neither a "water" nor a "sewer" service within the meaning of Article XIII D, § 6, subd (c) and therefore an

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[11] At the time, the answer might have been this: that some water fees are not property related does not mean none is, such as flat-rate water charges collected via the property tax roll without respect to use or occupancy of property. While not common, such fees exist in agricultural and other settings where water use is not metered.

[12] The author of this paper represented Salinas in this case.

election was required. As to "sewer" fees, the court relied on its sense of what the voters understood to limit these to sanitary sewers rather than storm sewers. As to "water," the court dismissed the Legislature's definition of the term in Government Code § 53750, subd. (m) without substantial analysis.[13]

More ominous still was the language of *Richmond v. Shasta Community Services District* (2004) 32 Cal.4th 409.[14] The Court ruled that a water connection charge was not a property related fee subject to Proposition 218 because decisions to establish new water service were voluntary and not mere incidents of property ownership. Moreover, an agency imposing such fees could not predict which property owners would seek to develop their properties so as to comply with the noticed hearing requirement of Article XIII D, § 6, subd. (a). Although the case was a victory for local governments, the following dicta foretold the current application of Proposition 218 to ordinary utility charges based on metered consumption:

> Presumably, any costs imposed on customers receiving service through existing connections would be subject to article XIII D's voter approval requirements, and thus their consent.

Id. at 420. The Court also stated, again in dicta:

> A fee for ongoing water service through an existing connection is imposed "as an incident of property ownership" because it requires nothing other

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[13] In light of the California Supreme Court's decision in *Greene v. Marin County Flood Control & Water Cons. Dist.* (2010) 49 Cal.4th 277 to treat the Proposition 218 Omnibus Implementation Act of 1997 as good authority for the construction of the measure, this rejection of Government Code § 53750, subd. (m) would seem ripe for reexamination.

[14] The author of this paper represented the Shasta CSD in the Supreme Court in this case.

> than normal ownership and use of property. But a fee for making a new connection to the system is not imposed "as an incident of property ownership" because it results from the owner's voluntary decision to apply for the connection.

Id. at 427.

The next year brought *Howard Jarvis Taxpayers Association v. City of Fresno* (2005) 127 Cal.App.4th 914.[15] Like the *Roseville* case from 2002, the conservative 5th District found that Fresno's general fund transfers from its water and sewer utilities violated Proposition 218 because no cost justification was provided for the use of sewer and water fee revenues for general fund purposes. Faced with a choice between *Apartment Association*'s apparent holding and *Richmond*'s articulate dicta, the court preferred the latter. The court rejected the City's contention that the transfers, which were authorized by a voter-approved provision of the City charter, might be viewed as a voter-approved general tax. This court, too, invited local governments to provide cost justification for transfers from water and sewer utilities to general fund by measuring the cost of such things as the impact of utility operations on roads and streets and the cost of police and fire protection of utility assets.

In 2006, the Supreme Court elevated the *Richmond* dicta to a holding in *Bighorn-Desert View Water Agency v. Verjil*, 39 Cal.4th 205. This case arose when a former member of the Agency's board and others pursued an initiative to reduce the Agency's water rates by half and to require voter approval of future water rate increases. When the

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[15] The author of this paper and Sandi Levin of Colantuono & Levin represented Fresno in this case.

County Registrar of Voters certified the measure for the ballot, the District brought a declaratory relief action against her to prevent an election on the measure, arguing it was not subject to the initiative power by virtue of Article XIII C, § 3 because metered water charges are not property related fees subject to Proposition 218. The California Supreme Court concluded otherwise[16] and found the measure valid insofar as it purported to lower water rates. However, the measure's provisions requiring voter approval of future rate increases contradicted the provisions of Article XIII D, § 6 for the imposition of such fees and this aspect of the measure was invalid and this flaw justified the trial court order barring election on the measure. The Court never mentions the *Apartment Association* case, the precise sweep of which is now uncertain, but expressly rejected the holding in *Howard Jarvis Taxpayers Ass'n v. City of Los Angeles* (2000) 85 Cal.App.4th 79. *Bighorn-Desert View, supra*, 39 Cal.4th at 217, n. 5.

Thus, the decade-long protection against application of Proposition 218 to charges for government-provided water, sewer and trash services ended with the *Bighorn* decision in 2006 and government water, sewer and trash service providers have had to grapple with the measure since. The reluctance of the local government community to negotiate legislative guidance regarding the fee provisions of Proposition

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[16] Articles XIII C and XIII D each provide definitions "as used in this article." By contrast, the Proposition 218 Omnibus Implementation Act provides definitions "for purposes of Articles XIII C and Article XIII D of the California Constitution and this article [*i.e.*, the Omnibus Act]." Government Code § 53750. Noting this point, the *Bighorn* Court determined that the fees within the sweep of the initiative provision of Article XIII C, § 3 included at least the fees defined in Article XIII D, § 6 without deciding whether Article XIII C, § 3 extended the initiative power to other fees as well.

218 ended and we now have two provisions of the Omnibus Act specific to fees: Government Code § 53755 provides guidance for notices of hearings on property-related fees pursuant to Article XIII D, § 6, subd. (a) and Government Code § 53756 authorizes rates set pursuant to Proposition 218 to authorize up to five years of scheduled increases or inflation adjustments before its hearing process must be repeated.

Since 2006, Proposition 218 litigation has continued to focus on definitional issues. *AB Cellular LA, LLC v. City of Los Angeles* (2007) 150 Cal.App.4th 747,[17] a dispute involving application of Los Angeles utility users tax on telephony, grappled with the definition of "increase" in Government Code § 53750, subd. (h). Increases in taxes, assessments and fees, of course, trigger compliance with Proposition 218's notice and election procedures. In particular, the decision found that Los Angeles had a "methodology" with respect to application of its phone tax that did not allow it to expand the tax base to include the call-detail portion of cell phone bills without voter approval. The term "methodology" appears in Government Code § 53750, subd. (h)(2)(B), which provides that "increase" excludes:

> an agency action that … [i]mplements or collects a previously approved tax or fee or charge, so long as the rate is not increased beyond the level previously approved by the agency, and the methodology previously approved by the agency is not revised so as to result in an increase in the amount being levied on any person or parcel.

[17] The author of this paper represented the City of Los Angeles in this case.

Pajaro Valley Water Management Agency v. AmRhein (2007) 150 Cal.App.4th 1364 grappled with the tension between *Apartment Association* and *Bighorn* in a case involving groundwater augmentation charges imposed on those who operated water wells in a basin affected by seawater intrusion. Was this a regulatory fee on business activity or a fee for a property related service? Initially the 6th District determined the fee exempt from Proposition 218, in reliance on *Apartment Association*. It published its decision two days after decision in *Bighorn*, however, and the court granted rehearing so it might reconsider its decision in light of *Bighorn*. On rehearing, the court concluded that the fees were subject to Proposition 218, not least because some 800 small pumpers were subject to the groundwater charge on account of domestic water use. If Proposition 218 protects urban water customers served by pipes, why should it not protect rural customers served via groundwater augmentation?

This holding has attracted considerable controversy. The 3rd District issued a *sua sponte* order in a challenge to a groundwater augmentation charge directing the parties to that case to file supplemental briefs on the question whether *Pajaro* was wrongly decided. *North San Joaquin Water Conservation District v. Howard Jarvis Taxpayers Ass'n*, 3rd District Court of Appeal Case No. C059758. However, initiative repeal of the questioned fee led the court to determine the appeal was moot and its potential disagreement with the 6th District has yet to come to fruition.

Several pending cases test this same issue — does Proposition 218 apply to groundwater augmentation charges? A second question arises, too — if such fees are subject to Proposition 218, are they "water" fees exempt from the election requirement of Article XIII D, § 6, subd. (c)? The answer to this question would seem to be "yes," given the definition of "water" in Government Code § 53750, subd. (m), but a published appellate authority is not yet available on the point.

Pending cases include *Great Oaks Water Co. v. Santa Clara Valley Water District*, 6th District Case No. H035885 (appeal from trial court ruling that district failed to comply with Prop. 218's procedures and its requirement that fees be limited to cost of service) which has been fully briefed since December 2011); *Griffith v. Pajaro Water Management Agency*, 6th District Case No. H038087[18] (challenge to fees imposed after election under Article XIII D, § 6, subd. (c) questioning use of weighted voting and details of calculation and adoption of fee), which has been fully briefed since January 2013; *Cerritos, Downey & Signal Hill v. Water Replenishment District of Southern California*, Los Angeles County Superior Court Case No. BS128136[19] (Judge Chalfant concluded WRD's fees subject to Prop. 218 and that WRD failed to comply with the measure), which remains in the trial court; and *City of San Buenaventura v. United Water Conservation District*, Santa Barbara Superior Court Case No. VENCI-00401714[20] (challenge to 3:1 ratio of M&I to agricultural rates under Propositions 13, 218 and 26 and other law), which set for bench trial April 30, 2013.

Clearly, the law of groundwater management and augmentation charges is developing quickly.

The California Supreme Court decided its second case involving Proposition 13's application to property related fees in 2010. *Greene v. Marin County Flood Control & Water*

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[18] The author of this paper is counsel to the Agency in this case.

[19] The author of this paper is counsel to the City of Cerritos in this case, but is not counsel of record.

[20] The author of this paper is counsel to the City of Ventura in this case.

Conservation District (2010) 49 Cal.4th 277[21] involved a challenge to the District's conduct of an election under Article XIII D, § 6, subd. (c) on a proposed flood control fee. The petitioner, an attorney and San Anselmo Town Council candidate,[22] suing in pro per, filed an election challenge, seeking to overturn approval of the fee. He argued that ballot secrecy should have been afforded, as Article II, § 7 of our Constitution requires for registered-voter elections. The California Supreme Court upheld the fee election, concluding that the provisions of Article II governing registered-voter elections do not apply to elections among property owners under Article XIII D, § 6, subd. (c) regarding property related fees. The Court also concluded that the Proposition 218 Omnibus Implementation Act of 1997 is good authority for the construction of the measure and that some level of deference is appropriate to local rules adopted for the conduct of property owner elections pursuant to Article XIII D, § 6, subd. (c). The Court refrained from deciding, because the facts of the case did not require it, whether ballots may be weighted according to property size, fee payment, or other indicia of benefits from or burdens on a fee-funded service program.[23]

The most recent development in the case law of property related fees is *Palmdale v. Palmdale Water District* (2011) 198 Cal.App.4th 926, which invalidated

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[21] The author of this paper represented the District in the California Supreme Court in this case.

[22] He was elected to the Council, arguably due to the publicity attained from his involvement in the case.

[23] This issue has attracted attention from the Howard Jarvis Taxpayers Association, which sponsored SB 553 (Yee, D-San Francisco) in 2013 to forbid weighted voting on property related fees. Local government organizations oppose that bill, noting that it violates the delegation to local government of powers to fashion rules for such fee elections by Article XIII D, § 6, subd. (c)'s final sentence.

conservation-based tiered water rates due to the lack of record support for the tiers the District established. Although taxpayer advocates read the case expansively to invalidate all conservation-based rates, the Court held that the mandate of Article X, § 2 of our Constitution to avoid waste of water can be harmonized with the mandate of Proposition 218 to limit fees to the cost of service. The court also found that the Palmdale District's rates, which deviated without articulate explanation from the recommendations of its rate consultant, were not supported by the record because no rationale was provided for the increase in rates between tiers or the water volumes used to define the tiers. Underlying the case was the fact that the District's changes to its rate-making consultant's proposal had the effect of shifting financial burden from residents (*i.e.,* District voters) to irrigators like the City, the community college, a hospital and other institutional customers (*i.e.*, non-voters).

Proposition 26:The Latest Initiative Development in Finance Law

In November 2010, California voters narrowly approved Proposition 26, a proposal of the California Taxpayers Association —a moderate, business-identified taxpayer advocacy organization. The primary goal of the measure was to undermine *Sinclair Paint Co. v. State Board of Equalization* (1997) 15 Cal.4th 866, which had upheld a fee on manufacturers of products containing lead to fund health services to low-income children adversely affected by environmental lead contamination. Sinclair Paint had argued the imposition was a tax requiring two-thirds legislative approval under Article XIII A, § 3, a provision of Proposition 13. The Court concluded otherwise, finding the

measure was related to the burdens imposed on society by those trading in lead-containing products and therefore not a tax.

A comprehensive discussion of Proposition 26 is beyond the scope of this paper. A number of detailed analyses of the measure are available.[24] In very broad terms, however, the measure defines every government imposition of a duty to pay funds to government as a tax unless one of seven stated exceptions applies. Article XIII C, § 1, subd. (e).[25]

> The measure states:
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> (e) As used in this article [i.e., Proposition 218's Article XIII C], "tax" means any levy, charge, or exaction of any kind imposed by a local government, except the following:
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> (1) 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.

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[24] League of California Cities, Proposition 26 Implementation Guide (April 2011) available at http://www.cacities.org/Prop26Guide. The author of this paper has published a paper on Proposition 26 on his website as well: Michael G. Colantuono, Proposition 26: New Limitations on Government Fees (Dec 2011), available at http://www.cllaw.us/papers/prop26_new_limitations.pdf. Cal. Tax has its own guide to the measure: California Taxpayers Association, Proposition 26: A Sponsor's Guide to California's New Tax Structure (August 2011), available at: http://www.caltax.org/UnderstandingProposition26.pdf.

[25] The measure has nearly parallel provisions for state and local governments. This paper discusses only the local government provisions. The provisions affecting state government appear in Article XIII A, § 3.

> (2) 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.
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> (3) A charge imposed for the reasonable regulatory costs to a local government for issuing licenses and permits, performing investigations, inspections, and audits, enforcing agricultural marketing orders, and the administrative enforcement and adjudication thereof.
>
> (4) A charge imposed for entrance to or use of local government property, or the purchase, rental, or lease of local government property.
>
> (5) 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.
>
> (6) A charge imposed as a condition of property development.
>
> (7) Assessments and property-related fees imposed in accordance with the provisions of Article XIII D.

Cal. Const. art. 13C, § 1, subd. (c).

The first three exceptions — for fees imposed for benefits or privileges conferred, services or products provided, or for reasonable regulatory costs — are all limited to the cost of service. The fourth and fifth exceptions — for fees imposed for the use of government property and fines and penalties — are not limited to cost. The final two exceptions (which have no analogs in the provisions of Proposition 26 applicable to state government) reference other bodies of law which limit fees to cost. Fees imposed as a condition of property development are limited to cost recovery by A.B. 1600 (Government Code § 66000 et seq.) and by the regulatory takings case law of the U.S. Supreme Court. *Nollan v. California Coastal Comm'n* (1987) 483 U.S. 825 (Coastal Commission exaction violated takings clause because not logically related to impacts of permitted development; *i.e.*, no "nexus" was shown); *Dolan v. City of Tigard* (1994)

512 U.S. 304 (City's exaction from hardware expansion project violated takings clause because not roughly proportionate in extent to the impacts of permitted development). The seventh exception is for assessments and property-related fees subject to Proposition 218 which, of course, are limited to cost by that measure.

Proposition 26 also added a final, unnumbered paragraph to Article XIII C, § 1, subd. (e)'s new definition of "tax," as follows:

> 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 no more than necessary to cover the reasonable costs of the 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.

Thus, the burden of proof shifts from a challenger of a government fee to the government, the lowest civil standard of proof applies, and the government must prove each of the following:

- The challenged fee is not a tax;
- It does not exceed the cost of service (unless other law exempts it from that showing, as the fourth and fifth exemptions to Proposition 26 do for charges for use of property and for fines and penalties);
- The allocation of costs bears a fair or reasonable relationship to the payor's burdens on or benefits received.

Proposition 26 is not retroactive as to local government (compare Article XIII A, § 3, subd. (c)'s retroactivity rule for state government to the Article XIII C, § 1, subd. (e) which has no comparable language for local government). However, procedural rules are not considered retroactive when applied to law suits decided after their adoption, even if arising from events which preceded their adoption. *E.g., Murphy v. City of*

Alameda (1992) 11 Cal.App.4th 906, 913; *Anton v. San Antonio Community Hospital* (1982) 132 Cal.App.3d 638, 650. Thus, even if Proposition 26's substantive requirements are not triggered until rate-making occurs after the November 2010 effective date of the measure, its burden-of-proof provision is immediately applicable to all pending rate disputes.

Proposition 26 Litigation

Two decisions involving Proposition 26 have now been published. First was *Griffith v. City of Santa Cruz* (2012) 207 Cal.App.4th 982, which found a rental housing registration and inspection fee was not a tax, but a valid licensing and permitting fee. The Court had little difficulty rejecting a challenge to the fees under Proposition 218, citing *Apartment Association of Los Angeles County, Inc. v. City of Los Angeles*.[26]

The Court concluded that Santa Cruz's fee was expressly exempted from Proposition 26's new definition of "tax" by exemption for regulatory fees of article XIII C, § 1, subd. (e)(3). This decision provides some sense of the scope of this exception. Santa Cruz's fee covered costs of inspecting and reinspecting units, documenting violations, advising property owners of needed corrections, referrals to code enforcement, registration of units, and administering landlord self-certifications. The

[26] The parties did not argue, and the Court therefore did not consider, whether Proposition 26 could apply retroactively to an ordinance adopted in September 2010 — before the November 2010 effective date of Proposition 26. The author of this paper won that point recently for the City of Redding in a challenge to a payment in lieu of taxes to its general fund from its electric utility. *Feefighter, LLC v. City of Redding*, Third District Court of Appeal Case No. C071906. That case is being briefed as this paper is written.

program funded salaries for two inspectors, one administrative assistant and other, undefined "administrative expenses." In addition "implementation would require 'supervisory support and support from staff of other departments [such as Finance and Fire.]'" This suggests the exception will be applied broadly and practically.

Discussing the provision of Proposition 26 that imposes the burden of proof on the City, the Court noted: "This language repeats nearly verbatim the language of prior cases assessing whether a purported regulatory fee was indeed a fee or a special tax," citing *San Diego Gas & Electric Co. v. San Diego Air Pollution Control District* (1988) 203 Cal.App.4th 1132, *Sinclair Paint* and *California Farm Bureau Federation v. State Water Resources Conservation Board* (2011) 51 Cal.4th 421.

We draw these conclusions from the case:

- The licensing and permitting exception will be applied practically and cover a reasonable range of costs attendant to regulatory programs.
- The burden to prove that fees will not exceed cost is not an overwhelming standard and reasonable decisions supported by evidence in court will be sustained.
- *Sinclair Paint* and other cases involving regulatory fees under Proposition 13 (which governments tended to win) will apply in construing Proposition 26.

The most recent decision under Proposition 26 is *Schmeer v. County of Los Angeles* (2013) 231 Cal.App.4th 1310 and involved a challenge to the County's plastic bag ban by a manufacturer of such bags. Specifically, the ordinance required retailers to charge $0.10 per paper bag and allowed them to keep the fees to fund the cost of providing bags and consumer education about waste reduction. The plaintiffs challenged this fee as a "tax" under Proposition 26. The Second District affirmed a trial court ruling for the

County concluding the measure was not a tax because it did not generate revenue for government. A petition for review in the case is still possible as this paper is written and may be likely.

Another recent case will be useful in construing the fifth exception to Proposition 26 for fines and penalties. *California Taxpayers Ass'n v. Franchise Tax Board* (2010) 190 Cal.App.4th 1129 challenged state legislation imposing a 20% penalty on late corporate taxes. The measure was projected to raise $1.4 billion and Cal. Tax. claimed that it was a tax for which the pre-Proposition 26 language of Article XIII A, § 3 required two-thirds approval by each chamber of the Legislature. The 3rd District disagreed, finding the measure was indeed a penalty because:

i. it was so labeled – a helpful, if not determinative fact;

ii. its revenues can be expected to fall over time as those subject to it change their behavior in response to the penalty; and,

iii. it is triggered by a violation of law.

This case will be useful in structuring fines and penalties that will not constitute taxes under Article XIII C, § 1, subd. (c).

Proposition 26 has produced litigation, of course, but not yet precedent. The pending cases are:

Citizens for Fair REU Rates v. City of Redding, Shasta Superior Court Case No. 171371. This case challenges a transfer from Redding Electric Utility to the City's general fund under Proposition 26. Judge William Gallaher ruled for the City, finding that Proposition 26 is not retroactive and that December 2011 rate-setting in question preserved, but did not increase, a pre-Proposition 26 payment in lieu of taxes (or

PILOT). The case is pending before the Third District as *Feefighter, LLC v. City of Redding*, Case No. C071906 and is being briefed as this paper is written.[27]

City of San Buenaventura v. United Water Conservation District, Santa Barbara Superior Court Case No. VENCI-00401714 is a challenge to the UWCD's groundwater augmentation charges, which maintain a statutory ratio of 3:1 of charges to municipal and industrial users of groundwater to those imposed on agriculture. The case alleges the fees violate Propositions 13, 218 and 26, as well as the common law of rate-making and the *San Marcos* legislation. Bench trial in the case is set for April 30, 2013.

Bauer v. Harris, Eastern District of California Case No. 11 CV 01440, filed August 25, 2011 is a challenge to gun registration fees under Proposition 26 and the Second Amendment. As this paper is written, the case is scheduled for a jury trial on January 28, 2014 before Judge Lawrence O'Neill.

[27] The author of this paper is counsel for the City of Redding in this case.

Conclusion

Over the course of 35 years, California's law of local revenues has been transformed. An earlier era of legislative discretion and deferential judicial review meant disputes over rates were more often resolved by political means than lawsuits. A steady erosion of government power to fund its services and a newly conservative and assertive judiciary has made a sea change in that law, especially as to rate-making. Rate-making now requires support from a consultant to ensure a defensible record and legal advice from the inception of rate-making to ensure compliance with the procedures required by Proposition 218 and other law, with the substantive rules for rates stated in all the law summarized here, and the creation of an adequate record on which to defend an agency's rates. Nevertheless, the public still expects government to provide basic services and the Constitution still permits government to recover its cost to do so. Thus, while rate-making is a more complicated and legally fraught process than in earlier times, it remains a legislative function of local government service providers.