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Prop. 26 May Require Less of Rate-Makers Than Previously Thought

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On December 4, 2017, the California Supreme Court decided its first major case under Proposition 26 and its most consequential case on water rates since 2006.

The Trial Court Litigation. The City of Ventura sued the United Water Conservation District to challenge its groundwater augmentation fees or "pump tax." The District charges municipal and industrial (M&I) groundwater users three times what farmers pay, not because it established that M&I groundwater users are more expensive to serve, but because a 1966 statute requires it to do so. We argued for Ventura that the 3:1 ratio violated Propositions 13, 218 and 26 and the common law of rate-making that applied before voters approved Proposition 13 in 1978. The City had statutory arguments, too.

Proposition 13 limits property taxes to 1% of sales price and requires two-thirds voter approval of "special taxes." The Legislature provided by statute that a fee which exceeds the cost of service is a special tax. Proposition 218 was adopted in 1996 to regulate assessments and "property related fees" — those on property owners or for a property related service. Proposition 26 came in 2010 to make **all** local government revenues taxes requiring voter approval unless one of seven stated or two implied exceptions applies. Three exceptions are relevant here — (i) revenues subject to Proposition 218 (assessments and property related fees) are not subject to the later measure, nor are (ii) fees for government services and (iii) fees for benefits or privileges provided service or benefit fees are limited to the cost of service and no one is served or provided the benefit at the expense of rate-payers ("no free-riders").

The trial court concluded the District could not show its fees were proportional to its cost to serve the City, as Proposition 218 required. It followed, as it was required to do, earlier rulings of the San Jose Court of Appeal concluding groundwater fees are subject to Proposition 218. Because Proposition 218 applied, Proposition 26 did not. The trial court ruled against the City on its Proposition 13, common law and statutory claims and the City pursued only the Proposition 26 and 218 issues on appeal.

The Court of Appeal Decision. The Ventura Court of Appeal concluded Proposition 218 did not apply because groundwater fees are not imposed on the City as a landowner, but as a groundwater pumper. It also concluded the rates did not recover more than the total cost of service — as to all pumpers — and that was sufficient to satisfy Proposition 26.

The Supreme Court Decision. The Supreme Court agreed with the appellate court that Proposition 218 does not apply because the City is not charged as a landowner, but as a groundwater user. It did not discuss the City's property rights in groundwater. However, the Court observed that Proposition 26 requires more than that

fees not exceed total service cost — each fee payor must also be charged in a "fair or reasonable relationship" to his or her "benefits from, or burdens on" the service. As the Court of Appeal failed to apply that test, the Supreme Court remanded the case for lower courts to do so.

The Court did not:

- give much guidance as to what Proposition 26 requires;
- decide whether the statute requiring a 3:1 ratio of fees on M&I groundwater users to fees on farmers violates Proposition 26, or
- whether the District can introduce evidence on remand in addition to the record on which it made its rates.

What About Proposition 218? Because we argued both Propositions 218 and 26 for the City, many expected the case to shed light on Proposition 218's requirements for water, sewer and solid waste fees. It does not. It merely holds that Proposition 218 applies only to fees on property owners as such, and not to fees imposed on conduct in addition to owning property.

So What Does it Mean? The case tells us a bit about groundwater charges and suggests where the law may be going.

Groundwater charges are now subject to Proposition 26, not Proposition 218, so there will be no 45-day noticed public hearing, submission of protests, or possible majority protest. Rate-making procedures will be governed by the statute which authorizes a particular fee. The *Griffith* and *Pajaro* decisions of the San Jose Court of Appeal are overruled to the extent they hold otherwise. Much of those decisions will still be good authority in Proposition 218 cases, though.

Groundwater charges pursuant to the Sustainable Groundwater Management Act (SGMA) are still subject to Proposition 218 because the statute says so. There may be efforts to amend it. The Court read SGMA's requirement of Proposition 218 compliance for water supply services (as opposed to regulatory activity by SGMA agencies) as a legislative addition to the requirements those agencies bear under the Constitution rather than a legislative interpretation of the Constitution.

Proposition 26's Allocation Requirement. The Court tell us little about Proposition 26's requirement that fees allocate cost among payers in a "fair or reasonable relationship" to a payor's "benefit from or burden on" a government service, leaving that to the lower courts to develop on remand. It did gives a few hints, however.

Citing *Jacks v. City of Santa Barbara*, a case we won earlier this year involving a charter city fee on an investor owner utility for use of City streets, the Court notes Proposition 26 codifies the *Sinclair Paint* decision allowing mitigation fees on businesses, with some changes as to regulatory fees. However, the Court expressly refrains from explaining what those changes are. Future litigation will develop that issue.

The Court cites also cites *Brydon v. EBMUD* — a Proposition 13 case upholding inclining block water rates that impose progressively higher rates for greater use of water to encourage conservation — to suggest Proposition 26's "fair and reasonable relation" test gives a fair amount of flexibility to rate-makers:

"To be sure, pre-Proposition 26 case law made clear that, '[i]n pursuing a constitutionally and statutorily mandated conservation program, cost allocations for services provided are to be judged by a standard of reasonableness with some

flexibility permitted to account for system-wide complexity.'"

This suggests that Proposition 26 test may be less demanding than previously thought. As noted above, the Court remanded for lower courts to apply the "fair or reasonable relationship test" and to determine if the statute requiring the 3:1 ratio of M&I to agriculture rates is constitutional. Thus, the case will return to lower courts and might well come back to the Supreme Court again. The case may take a few more years to resolve and may produce further published appellate authority. Justice Liu filed a brief concurring opinion stating the Court should have found the statute requiring a 3:1 ratio of fees for M&I and agricultural customers unconstitutional under Proposition 26.

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The Bigger Picture. Perhaps most interestingly, the case suggests the Supreme Court has a narrow view of Propositions 13, 218 and 26 — narrower than the 2006 Supreme Court which found Proposition 218 applicable to metered water rates and the San Jose Court of Appeal which extended it to groundwater charges.

The Court says, surprisingly, that special taxes under Proposition 218 are not the same as special taxes under Proposition 13 because Proposition 13 is limited to taxes on property. The parties did not brief or argue this issue. Taken in light of the Court's recent and controversial decision in *California Cannabis Coalition v. City of Upland*, it suggests this newly constituted Court (Governor Brown has filled three of seven seats in recent years and there is a vacancy that will soon give him a fourth) has a different view of initiative restrictions on government's power to fund services. *Upland* ruled an initiative general tax can be placed on a special election ballot because Proposition 218's rule restricting such taxes to general election ballots (when Council and Board seats are contested) applies only to government officials — not to initiative proponents.

If Proposition 13's two-thirds voter approval requirement applies only to special taxes on property, one can foresee a conclusion that initiative special taxes not on property might be approved by majority vote. The San Francisco City Attorney has published an opinion concluding just that. Republican Assemblymembers proposed ACA 19 to prevent such an outcome and an initiative constitutional amendment along those lines may not be far off.

Thus, the *Ventura* decision:

- Says little about retail water, sewer and trash rates or Proposition 218;
- Exempts groundwater charges for Proposition 218, applying the less demanding Proposition 26;
- Suggests Proposition 26 is less demanding than previously thought; and
- Opens the door to further case law restoring local government revenue authority thought lost to Propositions 13, 62, 218 and 26.

This, of course, will produce a reaction and the complex dance of California's democracy will continue. The law is in flux and change is coming. Stay tuned because, as always, we will keep you posted!

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