S224779

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

CITIZENS FOR FAIR REU RATES, et al.
Plaintiffs and Appellants,

v.

CITY OF REDDING, et al.
Defendants and Respondents

APPLICATION FOR LEAVE TO FILE *AMICI CURIAE* BRIEF AND PROPOSED *AMICI CURIAE* BRIEF OF THE LEAGUE OF CALIFORNIA CITIES AND THE CALIFORNIA STATE ASSOCIATION OF COUNTIES IN SUPPORT OF DEFENDANT AND RESPONDENT CITY OF REDDING

Review of a Published Decision of the
Third Appellate District, Case No. C071906

Reversing a Judgment of the Superior Court of
the State of California, County of Shasta,
Case No. 171377 (Consolidated with Case No. 172960)
Honorable William D. Gallagher, Judge Presiding

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes

APPLICATION FOR PERMISSION TO FILE *AMICI CURIAE* BRIEF

TO THE HONORABLE CHIEF JUSTICE OF THE SUPREME COURT OF THE STATE OF CALIFORNIA:

Pursuant to Rule 8.520, subdivision (f), the League of California Cities ("the League") and the California State Association of Counties ("CSAC") respectfully request permission of the Chief Justice to file the accompanying *amici curiae* brief in support of Defendant and Respondent City of Redding ("Redding").

The League is an association of 474 California cities dedicated to protecting and restoring local control to provide for the public health, safety, and welfare of their residents, and to enhance the quality of life for all Californians. The League is advised by its Legal Advocacy Committee, which is comprised of 24 city attorneys from all regions of the State. The Committee monitors litigation of concern to municipalities and identifies those cases that have statewide significance. The Committee has identified this case as having such significance. The League filed an *amici* brief in support of Redding in the appellate proceedings below and also submitted two *amicus* letters to this Court regarding this case, one dated March 19, 2015 (filed March 20) requesting depublication and one dated April 7, 2015 (received April 8) supporting the Petition for Review.

CSAC is a non-profit corporation whose membership consists of the 58 California counties. CSAC sponsors a Litigation Coordination Program, which is administered by the County Counsels' Association of California and is overseen by the Association's Litigation Overview Committee, comprised of county counsels throughout the state. The Litigation Overview Committee monitors litigation of concern to counties statewide

and has determined that this case is a matter affecting all counties because it concerns this Court's interpretation and application of Proposition 26 (Cal. Const., Art. XIII C, § 1, subd., (e)), adopted in 2010). Accordingly, CSAC joined with the League in the *amici* brief supporting Redding in the appellate proceedings below.

The League and CSAC and their member cities and counties have a substantial interest in the outcome of this case. The case raises important questions regarding the impact of Proposition 26 on municipalities that have long owned and operated their own municipal utilities. These questions include: (1) whether a long-standing interfund transfer between a city's utility fund and its general fund can be directly challenged as a "tax" subject to Proposition 26 or whether, instead, Proposition 26 only applies to the rates a municipal utility charges its customers, (2) whether a city's sale of electricity on the open wholesale market can ever be considered a "tax" subject to Proposition 26, and (3) how Proposition 26 affects pre-existing utility rates.

Like many California cities, Redding operates its own electric utility. It provides electric service to residents, businesses, and other customers within its boundaries, for which it charges utility rates. Redding generates its own electricity for this purpose, and it also generates excess electricity which it sells wholesale at market prices to other utility providers (such as Pacific Gas & Electric) and private corporations (such as the former Enron). For over 25 years, Redding has transferred certain money from its electric utility to its general fund, referred to as a "payment in lieu of taxes" or "PILOT." Many of the League's member cities who operate utilities have similar PILOTs or other such interfund transfers.

The Third District below held that this 25-year practice of transferring certain money from its electric utility fund to its general fund

constitutes a "tax" under Proposition 26. The League and CSAC believe this holding to be contrary to the plain language of Proposition 26, which defines "tax" as meaning "any levy, charge, or exaction of any kind *imposed* by a local government except the following: [list of seven exceptions]." (Cal. Const. art. XIII C, § 1, subd. (e); emphasis added.) The budgetary act of transferring sums from one fund to the other does not constitute any such imposition and thus cannot be found, by itself, to be a tax. (The *amicus* brief submitted on behalf of the plaintiffs by Glendale Citizens for Better Government actually advocates in agreement with the League and CSAC on this point.)

In the event of a legal challenge, rather than looking at an interfund transfer, a court's focus should instead be on the extent to which the electricity rates themselves comply with Proposition 26. Proposition 26 excepts from its definition of "tax" any "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." (Cal. Const. art. XIII C, § 1, subd. (e)(2); cf. Art. XIII A, § 3, subd. (b)(2) (substantially identical exception for State fees).) So Redding's utility rates could only be "taxes" if Redding directly charges its residents more than "the reasonable costs" that Redding incurs in providing the utility service. An interfund transfer (such as the PILOT here) would, at most, only be indirectly relevant to the analysis.

The Court of Appeal treated the PILOT as a charge directly subject to Proposition 26 and held that, after the passage of Proposition 26, Redding had to justify the PILOT as reasonable compensation for costs incurred by the general fund in the provision of electricity service. In doing so, the court effectively made Proposition 26 retroactive, even though the

court agreed it was not. Although the PILOT was valid under pre-Proposition 26 law, the Court of Appeal's holding rendered the PILOT invalid after the passage of Proposition 26, without any grandfathering. Had the Court of Appeal instead focused on Redding's electricity rates, it would have been compelled to find that Proposition 26 could not be applied retroactively to challenge the rates in existence before Proposition 26 was adopted in 2010 (even if those rates historically funded some share of the previously authorized PILOT), and Redding's rate increases after 2010 would not be subject to challenge under Proposition 26 so long as the increases were themselves justified by Redding's increased costs in providing services (and not by any increase in the PILOT).

In addition, if this Court were to hold Redding's entire PILOT subject to Proposition 26, it would call into doubt the ability of cities to sell electricity (and perhaps other utility commodities, such as water and natural gas) wholesale at market prices, effectively holding that cities may only sell electricity at actual cost. Redding's utility generates electricity in excess of its customers' needs, which it sells on the open market to wholesalers. The trial court found that the proceeds from such market sales were more than enough fund the PILOT, and yet the Court of Appeal held that the PILOT was subject to Proposition 26. In adopting Proposition 26, the electorate sought to restrict the ability of local agencies to "impose" taxes and fees on those who have no practical alternatives to those services, but it had no intent to regulate an agency's sale of a product on the open market to sophisticated market participants with alternative sources of supply. The Court of Appeal's holding has caused significant confusion and uncertainty for all publicly-owned utilities in California that sell electricity (or other utility commodities) on the open market, and then transfer a portion of the proceeds of such sales to their general funds.

The League and CSAC believe that their perspective will assist the Court in deciding this matter. The undersigned counsel has examined the briefs on file in this case and is familiar with the issues involved and the scope of their presentation. This *amici* brief primarily addresses relevant legal issues which were not presented in the parties' briefs.

In compliance with subdivision (f)(4) of Rule 8.520, the undersigned represents that his firm authored this brief in its entirety on a pro bono basis and is paying for its entire cost, and that no party to this action or any other person either authored this brief or made any monetary contribution to fund the preparation or submission of this brief.

We believe there is a need for additional briefing on this issue, and hereby request that leave be granted to allow the filing of the accompanying *amici curiae* brief.

JARVIS, FAY, DOPORTO & GIBSON, LLP

Dated: August 19, 2015 By: _____
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LEAGUE OF CALIFORNIA CITIES and
CALIFORNIA STATE ASSOCIATION OF
COUNTIES

AMICI CURIAE BRIEF

I. INTRODUCTION

This Court has identified three issues for its review of this case. In this brief, the League and CSAC will address two:

Issue #1: Is a payment in lieu of taxes (PILOT) transferred from the city utility to the city general fund a "tax" under Proposition 26 (Cal. Const., art. XIII C, § 1, subd. (e))?

Issue #3: Does the PILOT predate Proposition 26?

With regard to the first issue — whether a PILOT is a tax under Proposition 26 — the Court of Appeal focused on the wrong question. The appropriate question is not whether Redding's PILOT violates Proposition 26, but whether the rates Redding's electric utility ("the Redding Electric Utility" or "the Utility") charges to its retail customers violate Proposition 26. The PILOT is an internal budgetary transfer from the Utility's fund to Redding's general fund. Proposition 26 applies to a "levy, charge, or exaction of any kind imposed by a local government." (Cal. Const. art. XIII C, § 1, subd. (e).) The PILOT, however, is not "imposed" on anyone, and therefore it cannot, by itself, implicate Proposition 26. If any charge related to the Utility's provision of electricity service is "imposed," and is therefore subject to Proposition 26, it would be the rates charged by the Utility to its retail electricity customers. Consequently, the appropriate question is whether the Utility's retail rates comply with Proposition 26 — whether the retail rates exceed the reasonable cost to the Utility to provide electricity service to its retail customers.

The PILOT can only be relevant under Proposition 26 if it is funded by the retail rates and is therefore paid by the Utility's retail customers. But Redding has shown that the cost of the PILOT is more than covered by the Utility's other sources of income, in particular its sale on the wholesale

market of the electricity it produces. The trial court found no evidence that the PILOT is funded by the retail rates, and therefore Proposition 26 is not implicated. In fact, because the Utility's non-retail revenues exceed the PILOT transfers, it appears that the Utility's retail customers' rates are being subsidized by the Utility's non-retail revenues and are thus well within what Proposition 26 allows.

The League and CSAC are particularly concerned with the Court of Appeal's application of Proposition 26 directly to the PILOT rather than to the rates because it implies that the Utility's sale of electricity on the wholesale market is subject to Proposition 26. By focusing on the PILOT and holding that the PILOT must be justified by actual costs incurred by Redding's general fund, the Court of Appeal's holding suggests that if a municipal utility sells electricity or other commodity to corporate purchasers in the competitive wholesale marketplace, it cannot transfer the profits to its general fund. In effect, it can only sell at cost and cannot sell for a profit, even though the corporate purchasers will likely be reselling the electricity for their own profit. This was certainly not the purpose of Proposition 26, and the Court should make clear that Proposition 26 does not apply to wholesale transactions.

With regard to the third issue for review — whether the PILOT predates Proposition 26 — Redding has shown that the PILOT has been implemented unchanged since 2005. It certainly predates the 2010 adoption of Proposition 26, and therefore it should be grandfathered under the holding of *Brooktrails Township Community Services District v. Board of Supervisors of Mendocino County* (2013) 218 Cal.App.4th 195. The Court of Appeal's focus on whether the PILOT was implemented by ordinance, resolution, or budget draws a meaningless distinction. However adopted, the Redding City Council would have always had the discretion to amend

the PILOT, which the record shows it has done multiple times. Importantly, the PILOT has remained unchanged since 2005, well before the voters approved Proposition 26 in 2010.

But even if this Court decides the PILOT is not grandfathered, the fact that Proposition 26 is not retroactive should mean, at a minimum, that the rates in effect before Proposition 26 was passed should be grandfathered. Those rates should not be subject to Proposition 26, and only increases to those rates should be reviewed under Proposition 26.

II. BACKGROUND

Like many California cities, the City of Redding owns and operates a municipal utility, which provides electric service for Redding's residents and businesses. These retail customers pay Redding's electric rates for the service. Redding's utility also generates excess electricity which it has long sold on the open market — at market prices — to wholesalers, such as the former Enron. (See, e.g., *Public Utilities Com'n of State of Cal. v. F.E.R.C.* (9th Cir. 2006) 462 F.3d 1027 [demonstrating Redding's participation with Enron in the wholesale market regulated by F.E.R.C.].)

Redding maintains an operating fund for the Utility that includes income from its retail electricity rates and from its sale of excess electricity on the wholesale market, much of which is used to pay for the Utility's operating costs. And, like all cities and counties, Redding has a "general fund," that includes its discretionary income from various sources, such as general taxes, and which it uses to fund general municipal services. As the Court of Appeal acknowledged, some of Redding's general fund expenditures significantly benefit the Utility. (See *Citizens for Fair REU Rates v. City of Redding* [hereinafter "Opinion"] (Jan. 20, 2015, C071906) (formerly published at 233 Cal.App.4th 402) [pp. 21-22] ["Undoubtedly, Redding incurs costs to provide infrastructure and support to the Utility.

For example, Redding police protect the Utility property and the Utility's workers. Redding's streets, used by the Utility in its operations, are built and maintained by Redding's general fund. Redding's fire department stands ready to respond if a Utility transformer sparks a fire, or a downed tree cuts a live utility line, endangering Redding's citizens."].)

Redding has long transferred certain sums from its Utility fund to its general fund. Since 1988, the amount of this transfer has been calculated based on the amount of the one percent ad valorem property taxes the Utility would otherwise pay if it were a private rather than a public utility. This transfer is referred to as a "payment in lieu of taxes" or "PILOT." Many of the League's member cities who operate utilities have similar PILOTs. (See Opinion, p. 4, fn. 2 ["PILOTs are not uncommon among California municipalities."].)

In November 2010, the State electorate adopted Proposition 26, which amended Article XIII C of the California Constitution by adding a definition of "tax" as meaning "any levy, charge, or exaction of any kind imposed by a local government." The measure includes a list of seven exceptions, including "(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." (Cal. Const. art. XIII C, § 1, subd. (e)(2).)

In December 2010, Redding adopted a resolution increasing its electricity utility rates by just over 15 percent, with half of the increase effective in January 2011 and the remainder effective in December 2011. (See City of Redding's Opening Brief, filed June 1, 2015 [hereinafter "Opening Brief"], p. 11, citing IV AR Tab 163, pp. 1041-1042.) According to Redding, the purpose of the increase was to cover significant increases in

costs of generating electricity over recent years, during which Redding had previously deferred rate increases. (See Opening Brief at pp. 10-11, citing III AR Tab 140, pp. 797-800; IV AR Tab 159, p. 1031.)

Citizens for Fair REU Rates and Feefighter, LLC (hereinafter collectively "Citizens") filed two actions challenging Redding's December 2010 rate increases and its adoption of a biennial budget in June 2011. The actions were subsequently consolidated. Following a bench trial, the trial court entered judgment for Redding, and Citizens appealed.

The Court of Appeal held that "the PILOT constitutes a tax under Proposition 26 for which Redding must secure voter approval unless it proves the amount collected is necessary to cover the reasonable costs to the city to provide electric service." (Opinion, p. 3.) It further held that Redding may not make this budgetary transfer unless it can prove at trial that "the PILOT does not exceed reasonable costs . . . ." (Opinion, p. 4 [holding "Proposition 26 would nonetheless require the PILOT to either reflect the city's reasonable cost of providing electric service or be approved by voters."].)

III. ARGUMENT

A. Issue #1: Is a payment in lieu of taxes (PILOT) transferred from the city utility to the city general fund a "tax" under Proposition 26 (Cal. Const., art. XIII C, § 1, subd. (e)(1))?

1. The Court of Appeal asked whether the PILOT violates Proposition 26, when it should have asked whether the Utility's retail rates violate Proposition 26.

The entire focus of the Court of Appeal's decision was whether the PILOT is a tax under Proposition 26. The Court of Appeal began "by considering whether the PILOT constitutes a tax under Proposition 26." (Opinion, p. 7.) It concluded that "the PILOT constitutes a tax under

Proposition 26 unless Redding proves the amount collected is necessary to cover the reasonable costs to the city to provide electric service." (Opinion, p. 16.) And the Court remanded the case "for an evidentiary hearing in which Redding has the opportunity to prove the PILOT does not exceed reasonable costs under Article XIII C, section 1, subdivision (e)(2)." (Opinion, p. 4.)

But the PILOT itself cannot violate Proposition 26 because it has not been "imposed" on anybody. Proposition 26 applies to "any levy, charge, or exaction of any kind *imposed* by a local government." (Cal. Const. art. XIII C, § 1, subd. (e); emphasis added.)[1] The PILOT, however, is an internal budgetary transfer — a transfer from the Redding Electric Utility's fund to Redding's general fund. It is not imposed on anyone.

If the Redding Electric Utility imposes a "levy, charge, or exaction of any kind" in connection with its provision of electricity services, it does so by its charges to its retail customers. Therefore, to the extent Proposition 26 is an issue in this case, the proper question is whether the rates charged to the Utility's electricity retail customers comply with Proposition 26, and not whether the PILOT complies with Proposition 26.

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[1] The exceptions to Proposition 26 further indicate that Proposition 26 only applies to charges that are "imposed," since the exceptions almost uniformly apply to charges that are "imposed." In particular, the exception that would apply to charges for electricity service states that it applies to "[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." (Cal. Const. art. XIII C, § 1, subd.(e)(2); emphasis added.)

2. Proposition 26 should not apply to Redding's PILOT in the absence of evidence that the PILOT is funded by the rates charged to the Redding Electric Utility's retail customers.

To comply with Proposition 26, the rates charged to the Utility's retail customers cannot "exceed the reasonable costs to the [City] of providing the [electricity] service." (Cal. Const. Art. XIII C, § 1, subd. (e)(1).) The PILOT can only become relevant to this inquiry if the cost of the PILOT is funded by the rates, because then the question would arise whether the cost of the PILOT as embedded in the rates is a reasonable part of the cost of providing electricity service.

The Court of Appeal's focus on the PILOT was based on the apparent assumption that the PILOT is a component of the electricity rates paid by the customers and that, therefore, when the Utility's retail customers pay their electricity rates, they are necessarily also paying the PILOT. But contrary to this assumption, Redding has shown that its Utility's non-rate sources of revenue, in particular the Utility's sale of electricity on the wholesale market, are more than sufficient to pay the cost of the PILOT.[2] In fact, the trial court found that "there is no evidence that the PILOT is paid out of customers' rates." (Opening Brief, p. 38, citing 3 CT 74.) There is thus no basis for assuming that the PILOT is funded by the rates or is otherwise a component of the rates.

In fact, because the Utility's non-retail revenues significantly exceed the PILOT transfers, it appears that the non-retail revenues are subsidizing the retail customers, with the result that the retail customers are actually

[2] The Utility's revenues from wholesale customers and other non-rate sources are more than twice the PILOT. (City's Opening Brief, pp. 11, 35, 37-38, citing IV AR Tab 145, p. 831; IV AR Tab 149, p. 873; XIII AR Tab 205, p. 2975.)

paying less than the reasonable cost to the Utility to provide them with electricity, which explains why the Utility's rates are among the lowest in California. (City's Opening Brief, p. 7, citing IV AR Tab 166, pp. 1074, 1080-1085.)

That the PILOT is not funded by the rates paid by Redding's electricity retail customers distinguishes two Proposition 218 cases relied upon by both the Court of Appeal and Citizens: *Howard Jarvis Taxpayers Association v. City of Roseville* ("*Roseville*") (2002) 97 Cal.App.4th 637 and *Howard Jarvis Taxpayers Association v. City of Fresno* ("*Fresno*") (2005) 127 Cal.App.4th 914. (Opinion, pp 11-12, 14-15; Citizens' Answer Brief, filed July 2, 2015, pp. 25, 29.)

Roseville concerned an "in-lieu franchise fee" that a city transferred to its general fund from the enterprise funds of its water, sewer, and garbage utilities. (*Roseville* at p. 639.) The transfers were calculated at four percent of each utility's annual budget. (*Ibid.*) The plaintiffs argued that the transfers violated Proposition 218, and the court agreed, because section 6, subdivision (b), of Article XIII D of the California Constitution (part of Proposition 218) requires that the amount of a fee for a property-related service not exceed the cost to provide the service; that the revenues from such a fee only be spent on providing the service for which it is charged; and that revenues from such a fee not be spent on general governmental services. (*Id.* at p. 647.) The court could reach this conclusion because the in-lieu fees were "a blended component of the rates charged by those utilities" (*id.* at p. 647) and consequently were "paid by the utility ratepayers" (*id.* at p. 638).

Fresno involved a PILOT that was transferred to a city's general fund from its enterprise funds for its water, sewer, and garbage utilities. Similar to Redding's PILOT, the transfers were calculated at one percent of

the assessed value of the fixed assets of each utility. (*Fresno* at pp. 917-919.) The court found that these transfers violated both Proposition 218 and the city's charter. (*Id.* at p. 922.) Proposition 218 requires that revenues from a fee cannot exceed the funds needed to provide the service for which the fee is charged, and the charter prohibited the city from making a profit on its utilities. (*Id.* at p. 922.) Like *Roseville*, the *Fresno* court found that "[t]he amount paid by each utility [was] passed through to its customers. The overall amount of the in lieu fee [was] 'blended' into the user fees." (*Id.* at p. 918.)

In contrast, in the present case, the trial court found no evidence that Redding's PILOT is funded by its electricity rates. It is therefore irrelevant whether the PILOT is a reasonable reflection of the costs incurred by Redding's general fund in the provision of electricity. The question should only be whether the rates charged to Redding's retail electricity customers are a reasonable reflection of the cost of providing electrical service to those customers.

It is also worth noting that *Fresno* and *Roseville* concerned Proposition 218, which has stricter restrictions on utility rates than Proposition 26. While Proposition 26 only requires that charges for a service "not exceed the reasonable costs to the local government of providing the service" (Cal. Const. art. XIII C, § 1, subd. (e)(2)), Proposition 218 requires that "[r]evenues derived from [property-related fees] shall not exceed the funds required to provide the property related service . . . [and] shall not be used for any purpose other than that for which the fee or charge was imposed." (Cal. Const. art. XIII D, § 6, subd. (b).) Moreover, the amount of each property-related fee "shall not exceed the proportional cost of the service attributable to the parcel" and a property-related fee cannot "be imposed for general governmental services." (*Ibid.*)

This language is more restrictive than Proposition 26's requirement "that the manner in which those costs allocated to a payor bear a fair or reasonable relationship to the payor's burdens on, or benefits received from, the governmental activity." (Cal. Const. art. XIII C, § 1, subd. (e).) Importantly, Proposition 218 does not apply to fees for electricity services (Cal. Const., art. XIII D, § 3, subd. (b)), and therefore only Proposition 26 applies here.

3. By applying Proposition 26 directly to the PILOT, which is funded by Redding's sale of electricity on the wholesale market, the Court of Appeal has suggested that Proposition 26 applies to the wholesale of electricity.

Again, as the trial court found, the PILOT is easily funded by proceeds from Redding's sale of electricity on the wholesale market. Nevertheless, the Court of Appeal held that Proposition 26 applied directly to the PILOT and that therefore the PILOT could be no more than the actual costs incurred by Redding's general fund for the provision of electricity services. This holding strongly suggests that if a municipal utility sells electricity on the wholesale market place to electricity providers who in turn sell the electricity for a profit, the city cannot sell the electricity for more than the cost to produce the electricity — that the city cannot make a profit from such sales that it then remits to its general fund.

This Court should reject any such inference. Wholesale charges should not be subject to Proposition 26 because they are not "imposed." They are the result of a competitive marketplace and of contracts negotiated between sophisticated parties. In contrast to Redding's retail purchasers of electricity, who arguably do not have viable alternatives to buying Redding's electricity, wholesale purchasers have many options in the marketplace. If a city must sell wholesale electricity at cost, then the

ultimate profit from that electricity will go entirely to the corporate entity that resells it. While Proposition 26 was intended to protect individual citizens who have to purchase services from their local governments, it was not intended to prevent local governments from negotiating with private corporations for the profitable sale of a commodity produced by the city. Such a result would not follow from Proposition 26's purpose of reducing the cost of government, and indeed, it would be to the detriment of the local taxpayers Proposition 26 was intended to protect. Such taxpayers would clearly benefit from the use of the proceeds of such sales to private companies to help pay for general fund costs.

B. Issue #3: Does the PILOT predate Proposition 26?

1. Because the PILOT predates Proposition 26, it is grandfathered.

As the First District correctly held in *Brooktrails Township Community Services District v. Board of Supervisors of Mendocino County*, *supra*, 218 Cal.App.4th at 206-07, Proposition 26 is not retroactive as to local governments. Because Redding has shown that its PILOT has been implemented unchanged since 2005, its continued implementation does not implicate Proposition 26.

In this case, the Third District agreed that Proposition 26 is not retroactive, but decided — because the PILOT was implemented through Redding's biannual budgets and not through an ordinance — that it could not continue to be applied without complying with Proposition 26. But whether the PILOT was implemented by ordinance, resolution, or biannual budget is an unnecessary distinction that is ultimately meaningless here. The Court of Appeal's conclusion appears to reflect the erroneous belief that if the PILOT had been adopted by ordinance, the Redding City Council would have had less discretion to amend or terminate it, as compared to the

existing PILOT legislated through City budgets for 22 years. The court explained that "[t]he PILOT's regular appearance in Redding's budgetary process does not mean it was a permanent or continuing transfer compelled by ordinance or other non-discretionary authority." (Opinion, p. 19.) The court explained:

> "Each budget is a discretionary legislative act made by each city council. [Citation omitted.] The broad legislative discretion with which a city council is imbued stands in contrast to a tax or fee fixed by ordinance. In this case, each PILOT transfer represented a readoption in the discretion of each city council. Indeed, the record shows changes to the method of calculating the PILOT were made in 1992, 2002, and 2005. Consequently, the PILOT cannot be deemed to be grandfathered-in as preceding the 2010 adoption of Proposition 26." (Opinion, p. 18.)

However, the Redding City Council would have had ample discretion to amend an ordinance implementing a PILOT, just as it had discretion to modify the PILOT implemented through annual budgets. An ordinance can be amended or repealed at any time by a city council. In fact, any attempt to limit that discretion would be invalid.

> "Every legislative body may modify or abolish the acts passed by itself or its predecessors. This power of repeal may be exercised at the same session at which the original act was passed; and even while a bill is in its progress and before it becomes a law. The legislature cannot bind a future legislature to a particular mode of repeal. It cannot declare in advance the intent of subsequent legislatures or the effect of subsequent legislation upon existing statutes." (*County of Sacramento v. Lackner* (1979) 97 Cal.App.3d 576, 589-590 quoting *United Milk Producers v. Cecil* (1941) 47 Cal.App.2d 758, 764-765.)

However a PILOT is enacted, whether by ordinance, resolution, or any other action, a city council always has discretion to amend or terminate

it. That Redding's PILOT was not enacted by ordinance has no constitutional significance. What is important is that the city council continued the PILOT for more than twenty years before the adoption of Proposition 26 and that the PILOT was a well-established fixture in Redding's financial structure. That this was not done by ordinance should not be the basis for deciding that the PILOT is not grandfathered under Proposition 26.

2. At a minimum, the electricity rates in effect when Proposition 26 was adopted should be grandfathered.

Even if the PILOT itself was not grandfathered, the electricity rates in effect when Proposition 26 was adopted were, and only increases to those rates imposed after Proposition 26 should be evaluated under Proposition 26. Rates that existed when Proposition 26 was passed should, in effect, be treated as base rates that should be reviewed under pre-Proposition 26 law.

Until Propositions 218 and 26, rates charged by a municipal utility only had to be reasonable. (*Hansen v. City of Buenaventura* (1986) 42 Cal.3d 1172, 1180.) Municipal utility rates were presumed to be reasonable, fair, and lawful, and a plaintiff had the burden of showing that they were unreasonable or unfair. (*Id.*, at p. 1180.) A utility could be operated for a profit, and it could benefit the city's general fund. (*Id.* at p. 1183.)

Proposition 218 changed the standard for municipal water, sewer, and garbage fees (*Roseville*, *supra*, at p. 649; *Fresno*, *supra*, at p. 922), but left municipal electricity fees untouched because it explicitly does not apply to fees for electricity or gas (Cal. Const. art. XIII C, § 3, subd. (b)). Consequently, until the passage of Proposition 26, the standard set forth in *Hansen v. City of Buenaventura* applied to charges for electricity, and that is the standard that should be applied to the rates in existence when

Proposition 26 was adopted. Only increases in the rates since the passage of Proposition 26 should be reviewed under Proposition 26, and a municipal electrical utility should only be required to show that fee increases since Proposition 26 are supported by corresponding increases in the reasonable costs to provide the electricity service.

Furthermore, if a city established a rate formula before Proposition 26, that formula should be grandfathered. Provided the city maintains that formula, the rates should be secure; adhering to an established formula is not a tax increase. (Gov. Code § 53750; *AB Cellular LA, LLC v. City of Los Angeles* (2007) 150 Cal.App.4th 747, 763-64 [change in application of telephone tax was a change in "administrative methodology" and therefore a tax "increase" under Gov. Code § 53750, subd. (h) triggering voter approval requirement of Prop. 218].)

By focusing on the PILOT and not the rates, the Court of Appeal effectively made Proposition 26 retroactive, although it stated it agreed with *Brooktrails* that it is not. If the PILOT were a component of the Redding Electric Utility's rates before the passage of Proposition 26 (which has not been established, but which, as explained above would be necessary for Proposition 26 to apply to the PILOT), it is grandfathered as part of those pre-Proposition 26 rates and the Utility should be able to continue to include the PILOT in rates at the same level into the future.

By holding that after the adoption of Proposition 26 the PILOT must be justified by the actual costs incurred by Redding's general fund in the provision of electricity, the Court of Appeal effectively denied the grandfathering effect of Proposition 26 to the PILOT, which result is not supported by any language in Proposition 26 or the case law.

III. CONCLUSION

As the *Brooktrails* courts held, Proposition 26 does not apply retroactively to local fees and charges that pre-existed its adoption. The Court of Appeal below purported to agree with this holding, and even Plaintiffs do not dispute it. It thus follows that the electric utility rates charged by Redding prior to the effective date of Proposition 26 are grandfathered, regardless of whether those rates funded any portion of the PILOT challenged herein. It further follows that any increases in Redding's utility rates post-Proposition 26 should withstand legal challenge so long as those rate increases themselves are justified by increases in Redding's cost of providing electricity since it last adjusted its utility rates. A decision by any municipality to increase its rates should not open the door to a retroactive application of Proposition 26 to pre-existing rate practices and formulas, such as Redding's long-standing interfund budget transfer represented by the PILOT.

The facts of this case illustrate the significant complexity all municipalities may face if Proposition 26 is retroactively applied in such a manner. The trial court would have to engage in a complex historical factual analysis of the 25-plus year old PILOT transfer to determine what portion of the PILOT is actually funded by proceeds of Redding's utility rates (as opposed to other sources of income such as Redding's sale of excess electricity on the wholesale market) and then whether that portion exceeds the general fund's reasonable cost of providing various city services to the utility, including police, fire, public works, street maintenance, and other services.

While this issue is of obvious importance to local agencies that operate their own utility systems, it actually impacts every city and county in the State, each of whom provide many municipal services supported by

rate and fee structures that were in place when Proposition 26 was adopted. It was the intent of the voters to only apply Proposition 26 prospectively, and not to expose each municipality to complex and costly legal challenges to justify rates and fees that were already in place.

The League and CSAC thus urge this Court not to find Proposition 26 retroactively applicable to long-standing budgetary practices, such as the PILOT challenged in this case.

JARVIS, FAY, DOPORTO & GIBSON, LLP

Dated: August 19, 2015 By: _____
Benjamin P. Fay
Attorneys for *Amici Curiae*
LEAGUE OF CALIFORNIA CITIES and
CALIFORNIA STATE ASSOCIATION OF
COUNTIES

WORD COUNT CERTIFICATION

I certify that this brief and accompanying application contains a total of **6, 157** words as indicated by the word count feature of the Corel Word Perfect computer program used to prepare it.

Dated: August 19, 2015

Benjamin P. Fay

DECLARATION OF SERVICE

I, the undersigned, declare as follows:

I am a citizen of the United States and employed in the County of Alameda; I am over the age of eighteen years and not a party to the within entitled action; my business address is Jarvis, Fay, Doporto & Gibson, LLP, 492 Ninth Street, Suite 310, Oakland, California 94607.

On August 19, 2015, I served the within

APPLICATION FOR LEAVE TO FILE AMICI CURIAE BRIEF AND PROPOSED AMICI CURIAE BRIEF OF THE LEAGUE OF CALIFORNIA CITIES AND THE CALIFORNIA STATE ASSOCIATION OF COUNTIES IN SUPPORT OF DEFENDANT AND RESPONDENT CITY OF REDDING

on the parties in this action, by placing a true copy thereof in a sealed envelope(s), each envelope addressed as follows:

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I caused each such envelope, with postage thereon fully prepaid, to be placed in the United States mail to be mailed by First Class mail at Oakland, California.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed on August 19, 2015, at Oakland, California.

Jennifer Oberholzer