IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

No. S262634

Robert Zolly, Ray McFadden, and Stephen Clayton
Plaintiffs and Appellants,

vs.

City of Oakland
Defendant and Respondent

Answer to Petition for Review

After a Published Opinion
From the First District Court of Appeal, Division One
Appeal No. RG16821376
Superior Court of Alameda, Case No. RG16821376

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INTRODUCTION

In its petition for review, Oakland seeks to render obsolete this court's recent decision in *Jacks v. City of Santa Barbara* (2017) 3 Cal.5th 248 (*Jacks*). *Jacks* blocked one way that cities try to raise taxes without getting the requisite voter approval—by using a utility to collect an exorbitant amount from ratepayers and calling that amount a "franchise fee" (i.e., the price paid for the utility to use city property). *Jacks* held that, when a franchise-fee amount exceeds the value of the franchise conferred, that imbalance reveals the city has padded the fee with a tax subject to the voter-approval requirement of article XIII C of the California Constitution.

The Court of Appeal here held that *Jacks'* franchise-fee test applies to a newer version of article XIII C enacted through Proposition 26. (*Zolly v. City of Oakland* (2020) 47 Cal.App.5th 73, 88 (*Zolly*).) That

makes sense: voters enacted Proposition 26 to combat the very practice of disguising taxes as fees that *Jacks* blocked in the franchise-fee context. Yet Oakland is asking this court to turn Proposition 26 on its head by construing it to permit a franchise fee no matter the fee's amount or relationship to the franchise value. This court should decline that invitation.

LEGAL DISCUSSION

I. This court does not need to revisit the franchise-fee test it recently created in *Jacks*.

Just three years ago, *Jacks* resolved under what circumstances article XIII C of the California Constitution invalidates a charge styled as a franchise fee—the purchase price for a utility to use government property. (*Jacks, supra,* 3 Cal.5th at pp. 262, 267–271.) Voters in 1996 had enacted article XIII C to prevent cities from disguising taxes—which require voter consent—as fees. (*Apartment Ass'n of Los Angeles County, Inc. v. City of Los Angeles* (2001) 24 Cal.4th 830, 839.) *Jacks* held that, to determine "whether a charge that is nominally a franchise fee constitutes a tax depends on whether it is reasonably related to the value of the franchise rights." (*Jacks, supra,* at p. 271.) When the *price paid* for a franchise exceeds the *underlying value* of that franchise, it shows the city is trying improperly to extract revenue from ratepayers by using the utility as an artifice. (*Id.* at p. 269.)

And *Jacks* held that this franchise-fee test applies regardless of whether ratepayers pay the charge directly (as a line item on their utility bills) or indirectly (in the form of higher rates). (*Jacks, supra,* 3 Cal.5th at p. 269 & fn. 10.) *Jacks* reasoned that the method by which ratepayers pay the charge "does not alter the substance" or the "validity of the charge[]" under article XIII C because (1) either method results in a "payment made in exchange for a property interest that is needed" to run a utility; and (2) "a public regulated utility is a conduit through which government charges are ultimately imposed on

ratepayers" regardless of any intermediate payments made by the utility. (*Ibid.*)

To garner support for its petition here, Oakland's tries to muddy the clear meaning and scope of *Jacks*' franchise-fee test. (PFR 30–33.) Yet *Zolly* correctly ruled the test applies regardless of the charge's label or the method by which ratepayers pay the charge. (*Zolly, supra,* 47 Cal.App.5th at p. 85.) Thus, the only argument left for Oakland is that *Jacks*' test no longer applies because the charges at issue here are subject to an amended version of article XIII C. But, as explained below, *Zolly* correctly ruled that *Jacks*' test still applies.

II. Oakland's argument depends on the dubious proposition that the anti-tax Proposition 26 liberated cities to raise limitless revenue via utilities.

To address the problem of cities' continuing to disguise taxes as fees, voters in 2010 enacted Proposition 26 and thereby "made two changes to article XIII C" as originally enacted by Proposition 218. (*Citizens for Fair REU Rates v. City of Redding* (2018) 6 Cal.5th 1, 11 (*Citizens*).) "First, it specifically defined ' "tax," ' and did so broadly, to include 'any levy, charge, or exaction of any kind imposed by a local government.' (Art. XIII C, § 1, subd. (e).) However, the new definition has seven exceptions."[1] (*Citizens, supra,* at p. 11.) "Second, Proposition

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[1] Here are the seven exceptions:
(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.
(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.
(3) A charge imposed for the reasonable regulatory costs to a local government for issuing licenses and permits,

26 requires the local government to prove 'by a preponderance of the evidence that ... [an] 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.' (Art. XIII C, § 1, subd. (e).)" (*Citizens, supra,* at p. 11, alterations in original.)

Oakland contends that the fourth exception covers all charges that are nominally franchise fees. (PFR 19–30.) But that contention should be met with skepticism. As explained above in Part I, the original version of article XIII C provided that a so-called franchise fee was actually a tax to the extent its amount exceeded the reasonable value of the franchise. (*Jacks, supra,* 3 Cal.5th at pp. 269–271.) That limit was needed to prevent franchise fees from becoming "a vehicle for generating revenue independent of the purpose of the fees"—a "concern that is more than merely speculative." (*Id.* at p. 269.) And the whole point of Proposition 26 was to make it even *tougher* for cities to generate revenue from residents without getting voter consent. (See *Schmeer v. County of Los Angeles* (2013) 213 Cal.App.4th 1310, 1322

> 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. XIII C, § 1, subd. (e).)

[stating that Proposition 26 was "an effort to close perceived loopholes in Propositions 13 and 218"].)

Yet Oakland's interpretation of Proposition 26 would mean that the initiative *erased* Proposition 218's limit on franchise-fee amounts. This court should be extremely reluctant to adopt such a counterintuitive interpretation. (See *Boling v. Public Employment Relations Board* (2018) 5 Cal.5th 898, 918 [stating that this court avoids a construction that " ' "would result in an evasion of the evident purpose of [a statute]" ' " when possible], citation omitted and alteration in original.)

Fortunately—as *Zolly* correctly ruled——the current text of article XIII C does not compel that perverse result. (*Zolly, supra,* 47 Cal.App.5th at p. 88.) The fourth exception covers "[a] charge imposed for entrance to or use of local government property, or the purchase, rental, or lease of local government property." (Cal. Const., art. XIII C, § 1, subd. (e)(4).) And a city has the burden to prove by the preponderance of the evidence that a given charge fits within that exception. (Cal. Const., art. XIII C, § 1, subd. (e).) So how does a city prove that the whole amount of a charge is actually imposed for a utility's use of government property and not for revenue-generation unrelated to that use? *Jacks*' franchise-fee test still supplies the answer: it depends on whether the charge's amount "reflect[s] a reasonable estimate of the value of the franchise." (*Jacks, supra,* 3 Cal.5th at p. 267.) Only charges that pass this test are truly "amounts paid in exchange for property interests"—i.e., real franchise fees excepted from the definition of tax. (*Ibid.*)

Oakland relies on the fact that, in contrast to the first three exceptions, the fourth exception does not include the word "reasonable." But unlike the first three exceptions, which involve cities being reimbursed for *expenses*, a franchise fee is compensation for a city *asset*. (*Jacks, supra,* 3 Cal.5th at p. 268.) The first three exceptions, then, need the word "reasonable" to ensure that cities are not reimbursed for

profligate spending. (See Voter Information Guide, Gen. Elec. (Nov. 2, 2010) argument in favor of Prop. 26, p. 60 [stating that local politicians "need to control spending, not use loopholes to raise taxes"].) By contrast, the fourth exception does not need the word "reasonable" to provide a meaningful limit on franchise fees because the value of the relevant asset (i.e., the franchise) is set by the market. (See *Jacks, supra,* at p. 270.)

Moreover, Oakland ignores that the last three exceptions do not include the word "reasonable" either. Yet the amounts of the charges covered by those exceptions are limited by other constitutional provisions.[2] It makes no sense that voters would have enacted six limited exceptions and one limitless one—enticing cities to charge ever higher franchise fees. *Zolly* correctly reasoned that permitting cities to use utilities as intermediaries to raise revenue without getting voter consent "would directly conflict with the purpose of Propositions 218 and 26."[3] (*Zolly, supra,* 47 Cal.App.5th at p. 88.)

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[2] Charges imposed "as a result of a violation of law" under the fifth exception must be proportional under the excessive fines clauses of the state and federal Constitutions. (Cal. Const., art. XIII C, § 1, subd. (e)(5); see also *People ex rel. Lockyer v. R.J. Reynolds Tobacco Co.* (2005) 37 Cal.4th 707, 728; *Timbs v. Indiana* (2019) 139 S.Ct. 682, 689 [203 L.Ed.2d 11].) Charges "imposed as a condition of property development" under the sixth exception must be roughly proportional to the projected impact of the proposed development. (Cal. Const., art. XIII C, § 1, subd. (e)(6); see also *Ehrlich v. City of Culver City* (1996) 12 Cal.4th 854, 881; *Koontz v. St. Johns River Water Management Dist.* (2013) 570 U.S. 595, 612 [133 S.Ct. 2586, 186 L.Ed.2d 697].) And charges that are assessments or property-related fees under the seventh exception must be proportional to the special benefit or cost associated with each affected parcel. (Cal. Const., art. XIII C, § 1, subd. (e)(7); see also Cal. Const., art. XIII D, § 4, subd. (a) & § 6, subd. (b)(3).)

[3] The correctness of *Zolly* also means that this court should decline to depublish the opinion, which some organizations have requested.

III. Other recently published cases do not create a split requiring this court to grant review here.

Since *Zolly*, two cases have addressed issues under Proposition 26. But neither case creates a split that merits this court's review of this case.

First, *County Inmate Telephone Service Cases* (2020) 48 Cal.App.5th 354, 360–362 *(County Inmate*) applied to the article XIII C context the "general rule" that individuals do not have standing to seek a tax refund for taxes paid by someone else.[4] But, as *County Inmate* recognized, *Zolly* does not implicate that general rule because the *Zolly* plaintiffs seek only "declaratory and injunctive relief"—not a tax refund. (*Id.* at p. 362.) Given that *County Inmate* was decided upon taxpayer-standing doctrine, that case does not conflict with the merits ruling in *Zolly*. (See *Boorstein v. CBS Interactive, Inc.* (2013) 222 Cal.App.4th 456, 465 [ruling that a plaintiff's lack of standing is a threshold issue that prevents the court from reaching the merits].)

Second, *Howard Jarvis Taxpayers Association v. Bay Area Toll Authority* (June 29, 2020, No. A157598) __ Cal.App.5th ___ [2020 WL 3496798] (*Howard Jarvis*) ruled that a toll increase was not a state tax under article XIII A of the California Constitution because it fits within an exception for a " 'charge imposed for entrance to or use of state property[.]' " (*Id.* at *11, quoting Cal. Const., art. XIII A, § 3, subd. (b)(4).) That state-tax exception mirrors the municipal-tax exception at issue here. (*Id.* at *13, fn. 18.) But because *Howard Jarvis* did not involve a franchise fee, the court did not consider whether *Jacks'* franchise-fee test still applies after Proposition 26. And franchise fees involve unique features, including the exchange of money for a utility's right to run a local monopoly, which merit a different analysis than a fee to pay for government expenses such as the toll fee in *Howard Jarvis*. (See *id.* at *13, fn. 18 ["we of course express no opinion

[4] Appellants in *County Inmate* filed a petition for review on June 5, 2020, which is pending.

on [the *Zolly*] court's ultimate conclusion as to whether and when a franchise fee constitutes a tax"]; *Jacks, supra,* 3 Cal.5th at p. 268 [contrasting franchise fees with other fees that are "related to an expenditure by the government"].)

CONCLUSION

This court should deny the petition for review.

Respectfully submitted,
Katz Appellate Law

Dated: July 10, 2020

By /s/
Paul J. Katz
Attorney for Appellants

Respectfully submitted,
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Dated: July 10, 2020

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CERTIFICATE OF WORD COUNT

Appellants' counsel certifies in accordance with California Rules of Court, rule 8.504(d) that this brief contains 2,229 words as calculated by the Word software in which it was written.

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Respectfully submitted,

Dated: July 10, 2020

/s/

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STATE OF CALIFORNIA
Supreme Court of California

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