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File No. 09998.00264

July 8, 2020

The Honorable Chief Justice Tani Gorre Cantil-Sakauye
and the Associate Supreme Court Justices
Supreme Court of California
350 McAllister Street
San Francisco, CA 94102

Re: *Zolly v. City of Oakland*, S262634
Petition for Review – Amicus Curiae Letter (Cal. Rules of Court, rule 8.500(g))

Dear Chief Justice Cantil-Sakauye and Associate Justices:

I. Introduction

The League of California Cities (the "League") respectfully submits this letter as *amicus curiae* in support of the Petition for Review in *Zolly v. City of Oakland*. Supreme Court review is appropriate "[w]hen necessary to secure uniformity of decision or to settle an important question of law." (Cal. Rules of Court, rule 8.500(b)(1).) Review of *Zolly v. City of Oakland* (2020) 47 Cal.App.5th 73, 88, as modified on denial of reh'g (Apr. 17, 2020), review filed (June 8, 2020) (hereafter *Zolly*) is necessary to resolve conflicting published court decisions.[1]

First, the Court of Appeal created a conflict of law by viewing the burden of proof for cost-based fees in the last paragraph of article XIII C, section 1, subdivision (e)[2] as creating a substantive reasonableness requirement for paragraph (4) and for franchise fees. The *Zolly* appellate decision specifically conflicts with the Court of Appeal for the First Appellate District, District Two's decision in *Howard Jarvis Taxpayers Association v. Bay Area Toll Authority* (Cal. Ct. App., June 29, 2020, No. A157598) 2020 WL 3496798, at *1 (hereafter *Bay Area Toll Authority*). *Bay Area Toll Authority* looked to the ordinary meaning of the constitutional text in article XIII A, section 3, subdivision (d) to determine that it did not create a substantive requirement of reasonableness for a state fee imposed for the entrance or use of state property under article XIII A, section 3, subdivision (b), paragraph (4). (*Bay Area Toll Authority*, *supra*, at *12-13.) Article XIII A, section 3, subdivision (b), paragraph (4) and subdivision (d) are virtually identical to article XIII C, section 1, subdivision (e), paragraph (4), and the final paragraph of subdivision (e), respectively. Instead of the Constitution's ordinary meaning, *Zolly* relied on

[1] The League submitted a separate letter requesting *Zolly*'s depublication if the Court determines not to grant review.
[2] Unspecified references to "article" will refer to the California Constitution.

voter intent to reach a different conclusion. *Bay Area Toll Authority* rejected *Zolly*'s approach and explicitly disagreed with *Zolly*'s interpretation. (*Id.* at *13, fn. 18.) *Bay Area Toll Authority* and *Zolly* are both citable, published decisions in the First Appellate District. A conflict between published appellate decisions therefore exists.

Second, the Court of Appeal misapplied this Court's holding in *Jacks v. City of Santa Barbara* (2017) 3 Cal.5th 248 (hereafter *Jacks*) by conflating "cost" with "value." *Jacks,* on numerous occasions, distinguishes "cost" from "value," and by conflating these terms, *Zolly* directly conflicts with Supreme Court precedent by placing additional restrictions on fees for use of government property that do not exist in case law or in the Constitution. If left standing, *Zolly* would deprive League members of important rights as owners and managers of property and subject League members to legal challenge and expensive litigation over not only issuance of franchise and concessions, but virtually every arrangement for access, use, or possession of government property including negotiated leases, licenses, and arrangements for use of government property.

For the reasons discussed in this letter, the League respectfully requests this Court grant the petition of review for *Zolly*.

II. Statement Of Interest

The League is an association of 478 California cities united in promoting the general welfare of cities and their residents. The League is advised by its Legal Advocacy Committee, which is composed of 24 city attorneys representing all 16 geographical divisions of the League from all parts of the state. The committee monitors appellate litigation affecting municipalities and identifies those cases, such as the matter at hand, that are of statewide significance. The committee has determined this case is a matter affecting all cities. *Zolly* creates uncertainty for public agencies seeking to establish franchise fees, which were never intended to be further regulated by Proposition 26 in the first place. Conflating "cost" and "value" may impact other fees imposed for use of local government property, placing limited local government revenues at further risk. With *Jacks* on remand, the recent issuance of the conflicting published opinion in *Bay Area Toll Authority*, and with *Mahon v. City of San Diego* (D074877)[3] pending in the Court of Appeal, review is necessary to clarify confusion created by *Zolly*.

[3] The trial court in *Mahon* found that the surcharge was a franchise fee, and was limited by estimate of the value of the franchise, not by cost. Appellant Mahon's brief notes that "the trial court held the [undergrounding] surcharge is compensation for use of City streets … as 'a portion of the consideration for the granting of the franchise rights and privileges.'" (Brief for Appellant, *Mahon v. City of San Diego* (2019) (No. D074877), 2019 WL 1755763 at *30.) Respondent City of San Diego's brief notes, "the trial court correctly explained [that] the Supreme Court in *Jacks* allows flexibility as to what form franchise compensation may take and did not limit how that compensation is

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III. *Zolly*'s Interpretation Of The Burden Of Proof In Article XIII C, Section 1, Subdivision (e) Conflicts With *Bay Area Toll Authority*, A Published Appellate Court Decision

Zolly concluded that franchise fees must be reasonably related to the value of the franchise interest conveyed. (*Zolly*, *supra*, 47 Cal.App.5th at p. 88).) To reach this conclusion, *Zolly* relied on voter intent instead of the ordinary meaning of the words in article XIII C, section 1, subdivision (e). *Zolly* determined that the burden of proof provisions in article XIII C, section 1, subdivision (e) were intended by the voters to create a new substantive reasonableness requirement applicable to franchise fees: "On this question, we find the provision ambiguous and look to the intent and objective of the voters in enacting the provision to guide our interpretation." (*Id.* at p. 87.)

On June 29, 2020 the Court of Appeal for the First Appellate District, Division Two filed its published opinion in *Bay Area Toll Authority* interpreting an analogous provision applicable to State fees – article XIII A, section 3, subdivision (b), paragraph (4). This provision defines a State "tax" to include all charges not specifically exempt, and exempts "[a] charge imposed for entrance to or use of state property, or the purchase, rental, or lease of state property, except charges governed by Section 15 of Article XI." This language mirrors article XIII C, section 1, subdivision (e), paragraph (4). Both article XIII A, section 3, subdivision (d) and article XIII C, section 1, subdivision (e) contain virtually identical burden of proof language. The only difference between these provisions is the replacement of the word "State" for "local government" in article XIII A.

The Court of Appeal in *Bay Area Toll Authority* affirmed the trial court's conclusion that "the reasonable cost requirement of article XIII A, [section 3,] subdivision (d), did not apply to [subdivision (b), paragraph (4)] based on the plain meaning of the language used in section 3." (*Bay Area Toll Authority*, *supra*, 2020 WL 3496798 at *11).

> The first three exceptions [in Article XIII A, section 3, subdivision (b)] to the general definition of "tax" contain language limiting the charge to reasonable cost; the fourth and fifth exceptions do not. The absence of "reasonable cost" language in the latter exceptions, when it is present in the first three, strongly suggests the limitation does not apply where it is not stated … reading article XIII A, subdivision (d) of Section 3 as applicable to all of the subdivision (b) exceptions would render the express reasonableness language in the first three

calculated or charged. (*Id.*) *Jacks* must be understood to hold that all consideration that the City receives from [the utility] in exchange for the Franchise Rights is franchise compensation as that term is used in *Jacks*." (Brief for Respondent, *Mahon v. City of San Diego* (2019) (No. D074877), 2019 WL 3238984 at *35.)

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> exceptions surplusage. 'A construction making some words surplusage' is to be avoided.' [Citations.]

(*Id.* at *12.) The Court of Appeal in *Bay Area Toll Authority* noted its disagreement with *Zolly* regarding the application of the reasonableness standard:

> The *Zolly* court viewed the burden of proof provision of article XIII C, subdivision (e), as "requir[ing] that a charge be 'no more than necessary to cover the reasonable costs of the governmental activity'" and, because the provision is silent as to whether it applies to all the exemptions from the definition of "tax" or only the first three, which explicitly include a reasonableness requirement, found it ambiguous. [Citation.] The court therefore based its decision on the voters' intent, in passing Proposition 26, to "expand the definition of 'tax' to require more types of fees and charges be approved by two-thirds of the Legislature or by local voters." [Citation.] The *Zolly* court did not engage in the textual analysis that leads us to conclude subdivision (d) of article XIII A, section 3, does not impose a substantive requirement of reasonableness beyond that stated in subdivision (b) of this section. While we respectfully disagree with *Zolly* on the interpretation of the burden of proof provision, we of course express no opinion on the court's ultimate conclusion as to whether and when a franchise fee constitutes a tax.

(*Id.* at *13, fn. 18.)

The conflicting published opinions in *Bay Area Toll Authority* and *Zolly* will confuse the bench in their differing interpretations of the California Constitution. This Court should grant review in order to resolve the appellate level conflict as to the proper application of the reasonableness standard and statutory interpretation of article XIII A, section 3, subdivision (d) and article XIII C, section 1, subdivision (e).

IV. *Zolly* Creates A Conflict Of Law In Conflating "Cost" And "Value" In Article XIII C, Section 1, Subdivision (e)

This Court recognized that franchise fees historically have not been considered taxes. (*Jacks, supra*, 3 Cal.5th at pp. 262, 267.) In contrast to directly imposed taxes and fees, franchise fees are the product of contracts between sophisticated and capable parties, negotiated to compensate cities for a possessory interest in or special privilege to use public property and transact business in and with the city. (*Santa Barbara County Taxpayer Assn. v. Board of Supervisors* (1989) 209 Cal.App.3d 940, 949; *Southern Pacific Pipe Lines, Inc. v. City of Long Beach* (1988) 204 Cal. App. 3d 660, 666; 12 McQuillin Mun. Corp. § 34:2 (3d ed.).)

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The California voters adopted Proposition 26, which added article XIII C, section 1, subdivision (e) to the California Constitution. Proposition 26, for the first time, defined the term "tax" for purposes of California law, to include any fee or charge imposed by a local government that does not fall under one of seven express exemptions. Some of these exemptions included specific cost of service limitations, including fees or charges for services or products provided by local governments, privileges or benefits granted by local governments, or regulatory activities related to issuing permits. (Cal. Const., art. XIII C, § 1, subd (e)., pars. (1)-(3).) Other exemptions, including fees or charges imposed for the use of government property, had no restrictions. (Cal. Const., art. XIII C, § 1, subd. (e), par. (4).) The Court of Appeal in *Zolly* (*Zolly*, *supra*, 47 Cal.App.5th at p. 86) and this Court in *Jacks* (*Jacks*, *supra*, 3 Cal.5th at p. 263) found that franchise fees fall within that fourth exemption. The drafters and voters chose not to restrict franchise fees in Propositions 13, 62, 218, or 26. (*Jacks*, 3 Cal.5th at pp. 267-268.)

The common feature among the first three exemptions is that they must be based on the cost of the governmental activity. (*Id.*) No such requirement exists under subdivision (e)(4). Nonetheless, *Zolly* introduced the requirement that fees for use of government property must be reasonably related to the value of the interest conveyed by conflating "cost" and "value." *Zolly* relied on the final paragraph of article XIII C, section 1, subdivision (e):

> 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.

Value is not mentioned in this paragraph. This paragraph establishes evidentiary standards where a fee is based on "cost." These evidentiary standards require that, for cost-based fees, the local government must prove that a fee does not exceed the "reasonable costs" of the governmental activity, and that the "manner in which those costs are allocated" is reasonably related to the service or benefits provided. In *Jacks,* this Court made clear that franchise fees should not be limited by cost:

> - "More particularly, in connection with special assessments, the government seeks to recoup the costs of the program that results in a special benefit to particular properties, and in connection with development fees and regulatory fees, the government seeks to offset costs borne by the government or the public as a result of the payee's activities….In contrast, a fee paid for an interest in government property is compensation for the use or purchase of a

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government asset rather than compensation for a cost". (*Jacks, supra,* 3 Cal.5th at p. 268.)

- "Unlike the cost of providing a government improvement or program, which may be calculated based on the expense of the personnel and materials used to perform the service or regulation, the value of property may vary greatly, depending on market forces and negotiations." (*Id*. at p. 269.)

- "In addition, in contrast to fees imposed for the purpose of recouping the costs of government services or programs, which are limited to the reasonable costs of the services or programs, franchise fees are not based on the costs incurred in affording a utility access to rights-of-way." (*Id.* at pp. 273-274.)

"Cost" and "value" mean very different things. Cost relates to the effort or expenditure required to provide a service, product, or benefit. Value, on the other hand, relates to what a party is willing to pay. The repercussions of conflating the two terms are significant. By conflating "value" and "cost" in its opinion, the Court of Appeal confused the standards applicable to fees for use of government property.[4] Additionally, the Court of Appeal's reliance on the final paragraph of article XIII C, section 1, subdivision (e) and conflation of the terms "cost" and "value" suggests a different reasonable cost standard that would be more restrictive than *Jacks*. *Jacks* makes clear that proof of "**value** may be based on bona fide negotiations concerning the property's value, as well as other indicia of **worth**." (*Jacks*, 3 Cal.5th at p. 270, emphasis added.) Consistent with principles governing other fees, this Court held that, "to constitute a valid franchise fee under Proposition 218, the amount of the franchise fee must bear a reasonable relationship to the **value** of the property interests transferred." (*Id.,* emphasis added.)

Zolly's conflation of "cost" and "value" conflicts with this Court's decision in *Jacks.* It creates confusing standards that are damaging to public agencies seeking to adopt franchise fees. Accordingly, this Court should grant review to clarify that "cost" does not apply to this Court's "reasonable value" standard set forth in *Jacks*.

[4] Following the Court of Appeal's reasoning, if the final paragraph of article XIII C, section 1, subdivision (e) were to be interpreted to create new substantive requirements applicable to all seven exemptions, fines and penalties would also be subject to cost-of-service requirements. This would go against the very nature of fines and penalties, which are imposed for the purpose of dissuading certain activity, and would render an absurd and impossible result.

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V. *Zolly* Creates Confusing And Contradictory Standards That Will Damage Public Agencies

Zolly creates confusion that will significantly impact public agencies in California. First, the Court of Appeal imposed a reasonableness standard for franchise fees where the California Constitution does not. This imposition alone places existing franchise agreements at risk because it opens them up to retroactive review. In *Bay Area Toll Authority,* the Court of Appeal expressly rejected this interpretation with respect to analogous Constitutional provisions applicable to State fees. Further, in *Zolly,* the Court of Appeal's introduction of the concept of "reasonable value" for fees imposed for use of government property was intended to reconcile Proposition 26 with this Court's decision in *Jacks.* (*Zolly*, 47 Cal.App.5th at p. 88.) *Jacks* specifically found that franchise fees need not be based on cost, and conflating "cost" with "value" is inconsistent with this Court's position and decades of existing law. The Court of Appeal has created confusing inconsistencies for public agencies seeking to negotiate franchise fees.

California cities rely on franchise fee revenue to fund vital programs. These important revenues would be put at risk due to contradictory published appellate court decisions and the Court of Appeal's misapplication of *Jacks* in *Zolly*, which is citable case law. An analysis of local revenues available to California cities using data from the California state controller as of 2014-2015 found that a significant portion of unrestricted revenues available to California cities was attributable to franchise fees. (Coleman, *A Primer on California City Revenues, Part One: Revenue Basics* (Nov. 1, 2016) Western City.) Additionally, public agencies rely on other forms of unrestricted revenues, including lease revenues for rental of government property, that are also exempt from the definition of a "tax" under article XIII C, section 1, subdivision (e), paragraph (4). The magnitude of the harm would only be compounded by the loss of revenue and budget deficits caused by the COVID-19 pandemic.

VI. Conclusion

For all of the reasons discussed above, the League of California Cities respectfully requests this Court grant the City of Oakland's petition for review.

Sincerely,

Lutfi Kharuf
for BEST BEST & KRIEGER LLP

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CERTIFICATE OF SERVICE

Robert Zolly v. City of Oakland
Case No. S262634

At the time of service I was over 18 years of age and not a party to this action. My business address is 500 Capitol Mall, Suite 1700, Sacramento, California 95814. On July 8, 2020, I served the following document(s):

PETITION FOR REVIEW – AMICUS CURIAE LETTER (CAL. RULES OF COURT, RULE 8.500(g))

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Clerk of the Court
Hon. Paul D. Herbert
Alameda County Superior Court
1221 Oak Street
Oakland, CA 94612
(510) 263-4300

Trial Court Judge
[Case No. RG16821376]
Via U.S. Mail

I declare under penalty of perjury under the laws of the State of California that the above is true and correct. Executed on July 8, 2020, at Sacramento, California.

Claudia Peach

Claudia Peach

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