Indian Wells
(760) 568-2611
Irvine
(949) 263-2600
Los Angeles
(213) 617-8100
Manhattan Beach
(310) 643-8448

BEST BEST & KRIEGER LLP
ATTORNEYS AT LAW

655 West Broadway, 15th Floor, San Diego, CA 92101
Phone: (619) 525-1300 | Fax: (619) 233-6118 | www.bbklaw.com

Ontario
(909) 989-8584
Riverside
(951) 686-1450
Sacramento
(916) 325-4000
Walnut Creek
(925) 977-3300
Washington, DC
(202) 785-0600

Lutfi Kharuf

(619) 525-1302
Lutfi.Kharuf@bbklaw.com
File No. 09998.00264

June 29, 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*, A154986 (filed March 30, 2020)
Request for Depublication (Cal. Rules of Court, rules 8.1105(e)(2) & 8.1125)

Dear Chief Justice Cantil-Sakauye and Associate Justices:

The League of California Cities (the "League") respectfully requests depublication of *Zolly v. City of Oakland*, A154986 (filed March 30, 2020) (hereafter *Zolly*).

The League makes this request because *Zolly* mistakenly interprets article XIII C, section 1, subdivision (e) of the California Constitution. Despite its plain language, *Zolly* interprets the burden of proof provision of article XIII C, section 1, subdivision (e), to create a new substantive requirement for fees imposed for the use of government property, such as franchise fees. *Zolly* reached this conclusion by relying on perceived voter intent instead of the plain language of the Constitution. As explained further below, in *Howard Jarvis Taxpayers Assn. v. Bay Area Toll Authority* (June 29, 2020, A157598) ____ Cal.App.5th __, *Whitney v. Metropolitan Transportation Com.* (June 29, 2020, A157972) ____ Cal.App.5th __[consolidated cases] [pp. 30-31, fn. 18] (hereafter *Bay Area Toll Authority*), the Court of Appeal for the First Appellate District, Division Two, flatly rejected the analysis in *Zolly*, finding that analogous language in article XIII A, section 3, subdivision (d) of the California Constitution applicable to State fees did not create new substantive requirements applicable to fees for use of government property.

Further, even assuming a reasonableness standard applies, *Zolly* is internally contradictory and conflicts with the plain language of article XIII C, section 1, subdivision (e) of the California Constitution as well as with this Court's decision in *Jacks v. City of Santa Barbara* (2017) 3 Cal.5th 248 (hereafter *Jacks*). *Zolly* deserves depublication because it misapplies *Jacks* by conflating *Jacks'* holding that franchise fees must reasonably relate to the ***value*** of the franchise interest conveyed, with the requirement applicable to fees for benefits, services, or

regulatory activity (but not to franchise fees), that such fees be reasonably related to the ***cost*** of providing the benefit, service, or regulatory activity for which they are imposed.[1]

Depublication is appropriate when "a majority of the justices consider the opinion to be wrong in some significant way, such that it would mislead the bench and bar if it remained as citable precedent.'" (Grodin, *The Depublication Practice of the California Supreme Cour*t (1984) 72 Cal. L. Rev. 514, 514 citing *Decertification of Appellate Opinions: The Need for Articulated Judicial Reasoning and Certain Precedent in California Law* (1977) 50 S. Cal. L. Rev. 1181, 1185 fn. 20 (quoting letter from California's former Chief Justice Wright).) Conflating "value" with "cost" in article XIII C, section 1, subdivision (e) as *Zolly* does, is wrong. If *Zolly* remains published, it will cause significant confusion in the already precarious area of law governing public agencies' local revenues. *Zolly* will mislead the bench and bar by applying the evidentiary standard applicable to demonstrating reasonable "cost" in contravention of *Jacks* test for determining reasonable "value." As this Court made clear in *Jacks*, "cities are free to sell or lease their property, and the fact that a franchise fee is collected for the purpose of generating revenue does not establish that the compensation paid for the property interests is a tax. 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." (*Jacks*, *supra*, 3 Cal. 5th at pp. 273–274.)

I. 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 regulated by Proposition 26 in the first place. Furthermore, with *Jacks* on remand, and *Mahon v. City of San Diego* (D074877) pending before the Court of Appeal, depublication is necessary to rectify confusing standards for franchise fees created in *Zolly*.

[1] "Just as the amount of fees imposed to compensate for the expense of providing government services or the cost of the public associated with a payer's activities must bear a reasonable relationship to the costs and benefits that justify their imposition, fees imposed in exchange for a property interest must bear a reasonable relationship to the value received from the government." (*Jacks*, *supra*, 3 Cal.5th at p. 269.)

The uncertain standard will subject franchise fees across the State to unnecessary litigation, placing valuable public resources at risk at a time when public agencies already face limited budgets and financial hardship. As such, for the reasons discussed in this letter, the League respectfully requests the Court of Appeal opinion be depublished.

II. *Zolly* Mistakenly Applies a Reasonableness Standard Despite the Plain Language of Article XIII C, Section 1, Subdivision (e)

Zolly concluded that franchise fees must be reasonably related to the value of the franchise interest conveyed, despite the plain language of article XIII C, section 1, subdivision (e) of the California Constitution. To reach this conclusion, *Zolly* relied on *Jacks*, which was a case involving a fee predating article XIII C, section 1, subdivision (e). In order to harmonize *Jacks* and the subsequent amendment to the Constitution in article XIII C, section 1, subdivision (e), *Zolly* found that despite its plain language, the burden of proof provisions in article XIII C, section 1, subdivision (e) was *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." (*Zolly*, 47 Cal.App.5th at p. 87.)

Today, the Court of Appeal for the for the First Appellate District, Division Two, released its opinion in *Bay Area Toll Authority* interpreting an analogous provision applicable to State fees. Article XIII A, section 3, subdivision (b)(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)(4). Both article XIII A, section 3, subdivision (d) and article XIII C, section 1, subdivision (e) contain virtually identical burden of proof language. *Bay Area Toll Authority* disagreed with *Zolly*:

> 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. (*Zolly*, *supra*, 47 Cal.App.4th at p. 87.) 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." (*Zolly*, at p. 88.) 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.

If *Zolly* remains published, it will lead to further litigation and will confuse the bench because it misinterprets the California Constitution, and conflicts with other Court of Appeal precedent. *Zolly* improperly relies on voter intent instead of the plain language of article XIII C, section 1, subdivision (e) to reach this conclusion, and to reconcile its opinion with *Jacks*, a case involving a fee that predated article XIII C, section 1, subdivision (e).

III. The Court of Appeal Mistakenly Conflated "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.).)

California has a history of increasingly stringent, voter-driven regulation on local revenue exceeding forty years. Beginning with Proposition 13 in 1978, and including Proposition 62 in 1986, Proposition 218 in 1996, and most recently, Proposition 26 in 2010, these restrictions have severely impacted cities' ability to generate revenue and fund essential municipal services.

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 Court of Appeal acknowledges that the "fourth exemption does not expressly state the charge for entrance to or use of local property must be reasonable." (*Zolly*, *supra*, 47 Cal.App.5th at p. 86.) In contrast, the first three exemptions for fees imposed for privileges or benefits granted by a local government, products or services provided by a local government, or regulatory fees related to issuance of permits, "explicitly include such a [reasonableness] requirement." (*Id.*) The common feature in article XIII C, section 1, subdivision (e) among the first three exemptions is that they must be based on the cost of the governmental activity. (*Id.*) The Court of Appeal mistakenly introduced the requirement that fees for use of government property must be reasonably related to the value of the interest conveyed, based on this Court's decision in *Jacks.* The Court of Appeal relied on the final paragraph of article XIII C, section 1, subdivision (e), which establishes the evidentiary standard for cost-based fees:

> 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 mentioned nowhere in this paragraph. Rather, 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. Without explanation, the Court of Appeal conflates the requirements applicable to "cost" with the requirements applicable to establishing "value." The Court of Appeal looked to *City of San Buenaventura v. United Water Conservation Dist*. (2017) 3 Cal. 5th 1191, 1214 (*United Water Conservation Dist*.) – a case dealing with a regulatory groundwater extraction fee and not for a fee for use of government property – for the proposition that "to qualify as a nontax 'fee' under article XIII C … a charge [imposed by a local government] must satisfy both the requirement that it be fixed in an amount that is 'no more than necessary to cover the reasonable costs of the governmental activity,' and the requirement 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.'" (*Zolly*, 47 Cal.App.5th at pp. 552-553 quoting *United Water Conservation Dist*., 3 Cal. 5th at p. 1214.) Nowhere in the opinion is there any guidance on how to reconcile a cost-based approach with franchise fees, which are not based on cost.

IV. *Zolly* Creates Confusing and Contradictory Standards That Will Damage Municipalities Statewide

"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. As this Court distinguished in *Jacks*, "[u]nlike 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." (*Jacks*, 3 Cal.5th at p. 269.) By conflating "value" and "cost" in its opinion, the Court of Appeal confused the standards applicable to fees for use of government property.[2] Additionally, the Court of Appeal's mistaken 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.)

V. Conclusion

Accordingly, the Court of Appeal erred in applying the evidentiary standard in article XIII C section 1, subdivision (e) to franchise fees under the fourth exemption when the evidentiary standard only applies to the first three exemptions. The requirement that a local government be able to prove that a charge or fee it imposes is limited to "reasonable costs" should be limited to the first three exemptions (special benefits, user fees, and regulatory fees) which expressly include a "reasonable costs" requirement.

The Court of Appeal's decision 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 mistake, alone, casts existing franchise agreements into a difficult position because it opens them up to retroactive review, despite decades of case law to the contrary. In *Bay Area Toll Authority*, the Court of Appeal expressly rejected this interpretation with respect to analogous Constitutional provisions

[2] 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.

applicable to State fees and charges. Further, 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. By conflating the terms "cost" and "value" in an attempt to reconcile Proposition 26 and *Jacks*, the Court of Appeal has potentially created a confusing inconsistency.

Cities throughout the State rely on franchise fee revenue to fund vital programs. If *Zolly* remains published, these important revenues would be put at risk due to contradictory guidance on how to keep them in place. 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.) The magnitude of the harm would only be compounded by the loss of revenue and budget deficits caused by the COVID-19 pandemic.

For all of the reasons discussed above, the League of California Cities respectfully requests the Court of Appeal opinion be depublished.

Sincerely,

Lutfi Kharuf
for BEST BEST & KRIEGER LLP

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 655 West Broadway, 15th Floor, San Diego, California 92101. On June 29, 2020, I served the following document(s):

REQUEST FOR DEPUBLICATION

☒ **By e-mail or electronic transmission.** Based on a court order or an agreement of the parties to accept service by e-mail or electronic transmission via Court's Electronic Filing System (EFS) operated by ImageSoft TrueFiling (TrueFiling) as indicated on the attached service list.

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I am a resident or employed in the county where the mailing occurred. The envelope or package was placed in the mail at Colton, California.

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 June 29, 2020, at San Diego, California.

Sandra Rosales

Service List

Individual / Counsel	***Party Represented***
Andrew M. Zacks Zacks Freedman & Patterson, PC 235 Montgomery Street, Suite 400 San Francisco, CA 94104 (415) 956-8100 • FAX: (415) 288-9755 az@zfplaw.com	Plaintiffs and Appellants **ROBERT ZOLLY, RAY McFADDEN, and STEPHEN CLAYTON** ***Via TrueFiling***
Paul J. Katz Katz Appellate Law 484 Lake Park Avenue, Suite 603 Oakland, CA 94610 (510) 920-0543 • FAX: (510) 920-0563 paul@katzappellatelaw.com	Plaintiffs and Appellants **ROBERT ZOLLY, RAY McFADDEN, and STEPHEN CLAYTON** ***Via TrueFiling***
Cedric C. Chao Chao ADR, PC One Market Street Spear Tower, 36th Floor San Francisco, CA 94105 (415) 293-8088 cedric.chao@chao-adr-com	Defendant and Respondent **CITY OF OAKLAND** ***Via TrueFiling***
Stanley J. Panikowski Jeanette Barzelay Tamara Shepard DLA Piper LLP 555 Mission Street, 24th Floor San Francisco, CA 94105 (415) 836-2500 • FAX: (415) 836-2501 stanley.panikowski@us.dlapiper.com jeanette.barzelay@us.dlapiper.com tamara.shepard@us.dlapiper.com	Defendant and Respondent **CITY OF OAKLAND** ***Via TrueFiling***
Laura E. Dougherty Howard Jarvis Taxpayers Association 921 11th Street, Suite 1201 Sacramento, CA 95814-2822 (916) 444-9950 • FAX: (916) 444-9823 laura@hjta.org	**HOWARD JARVIS TAXPAYERS ASSOCIATION** ***Via TrueFiling***

Individual / Counsel	*Party Represented*
Barbara Parker Doryanna Moreno Maria Bee David Pereda Celso Ortiz Zoe Savitsky Oakland City Attorney's Office City Hall, 6th Floor 1 Frank Ogawa Plaza Oakland, CA 94612 (510) 238-3601 • FAX: (510) 238-6500 bparker@oaklandcityattorney.org dmoreno@oaklandcityattorney.org mbee@oaklandcityattorney.org dpereda@oaklandcityattorney.org cortiz@oaklandcityattorney.org zsavitsky@oaklandcityattorney.org	Defendant and Respondent **CITY OF OAKLAND** ***Via TrueFiling***
Beth J. Jay Jason R. Litt Jeremy B. Rosen Joshua C. McDaniel Horvitz & Levy 3601 W. Olive Ave., 8th Fl. Burbank, CA 91505 (818) 995-0800 Bjay@horvitzlevy.com jlitt@horvitzlevy.com jrosen@horvitzlevy.com jmcdaniel@horvitzlevy.com Barrett S. Litt Ronald O. Kaye Kaye, McLane, Bednarski & Litt LLP 975 East Green Street Pasadena, CA 91106 blitt@kmbllaw.com rok@kmbllaw.com Michael S. Rapkin Scott B. Rapkin Rapkin & Associates, LLP 11543 W Olympic Blvd Fl 2, Los Angeles, CA 90064-1508 msrapkin@gmail.com scottrapkin@rapkinesq.com	**JAIL INMATES AND THEIR FAMILIES** ***Via TrueFiling***

Individual / Counsel	*Party Represented*
California Court of Appeal First Appellate District, Division 1 350 McAllister Street San Francisco, CA 94102 (415) 865-7300	[Case No. A154986] ***Via TrueFiling***