Court of Appeal, Second Appellate District
Daniel P. Potter
Electronically RECEIVED on 8/7/2020 on 1:31:21 PM

Court of Appeal, Second Appellate District
Daniel P. Potter
Electronically FILED on 8/7/2020 by Yalitza Esparza, Deputy Clerk

NO. B299297
(Earlier Review in B290938, B253474)

IN THE COURT OF APPEAL, STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT, DIVISION SIX

ROLLAND *JACKS* and ROVE ENTERPRISES, INC.
Petitioners and Appellants,

Vs.

CITY OF SANTA BARBARA,
Defendant and Respondent,

Appeal from the Superior Court of the State of California
For the County of Santa Barbara, Case No. 1383959
Honorable Thomas P. Anderle, Judge Presiding

APPLICATION OF THE LEAGUE OF CALIFORNIA CITIES TO FILE AMICUS CURIAE BRIEF IN SUPPORT OF DEFENDANT AND RESPONDENT CITY OF SANTA BARBARA; AMICUS CURIAE BRIEF

MARA W. ELLIOTT, City Attorney
GEORGE F. SCHAEFER, Assistant City Attorney
MEGHAN ASHLEY WHARTON, Senior
Deputy City Attorney (Bar No. 250498)

OFFICE OF THE SAN DIEGO CITY ATTORNEY
Civil Division
1200 Third Avenue, Suite 1100
San Diego, California 92101
Telephone: (619) 533-5800
Facsimile: (619) 533-5856
Email: mwharton@sandiego.gov

Attorneys for Amicus Curiae League of California Cities

CERTIFICATE OF INTERESTED ENTITIES OR PARTIES

1. This form is being submitted on behalf of the following party: (name): THE LEAGUE OF CALIFORNIA CITIES
2. a. ☒ There are no interested entities or persons that must be listed in this certificate under rule 8.208

   b. ☐ Interested entities or persons required to be listed under rule 8.208 are as follows:

	Full name of interested entity or person	Nature of interest (Explain):
1.		
2.		
3.		
4.		
5.		

The undersigned certifies that the above-listed persons or entities (corporations, partnerships, firms, or any other association, but not including government entities or their agencies) have either (1) an ownership interest of 10 percent or more in the party if it is an entity; or (2) a financial or other interest in the outcome of the proceeding that the justices should consider in determining whether to disqualify themselves, as defined in rule 8.208(e)(2).

Date: August 7, 2020

Signed: */s/ Meghan Ashley Wharton*

MEGHAN ASHLEY WHARTON

TABLE OF CONTENTS

CERTIFICATE OF INTERESTED ENTITIES OR PARTIES 2

TABLE OF CONTENTS 5

TABLE OF AUTHORITIES 6

APPLICATION OF THE LEAGUE OF CALIFORNIA CITIES TO FILE AMICUS CURIAE BRIEF IN SUPPORT OF RESPONDENT CITY OF SANTA BARBARA 9

BRIEF OF AMICUS CURIAE 13

INTRODUCTION 13

STATEMENT OF FACTS 15

PROCEDURAL HISTORY 16

I. A CITY RECEIVES COMPENSATION FROM A UTILITY IN EXCHANGE FOR FRANCHISE RIGHTS 16

A. California Cities Generate Revenue for Government Services by Charging Utilities for Franchise Rights 16

B. Charter Cities Lawfully Command More Compensation from Utilities for Franchise Rights than General Law Cities 18

C. Utilities Recover the Expense of Franchise Compensation from Ratepayers; Above-Average Franchise Compensation Paid to Charter Cities May Require a Surcharge 20

II. OVER THE PAST FORTY YEARS VOTERS ENACTED RESTRICTIONS ON LOCAL REVENUE MEASURES BUT FRANCHISE COMPENSATION REMAINED UNTOUCHED AS AN IMPORTANT SOURCE OF CITY REVENUE TO FUND CORE GOVERNMENT SERVICES 22

A. Proposition 13 Significantly Reduced Cities' Discretionary Revenue and Restricted the Adoption of Special Taxes but did not Restrict Cities' Ability to Leverage Public Property for Compensation, Including Franchise Compensation 23

B. Proposition 62 Limited Cities' Authority to Impose General and Special Taxes, but did not Limit a City's Authority to Leverage Public Property for Compensation, Including Franchise Compensation 25

C. Proposition 218 Reaffirmed the Voter Assent Requirements for Taxes and Imposed Rigorous Procedural Requirements for Property-Related Fees, Charges and Assessments but did not Impact Cities' Ability to Leverage Public Property for Compensation, Including Franchise Compensation 26

D. Proposition 26 Defines the Term "Tax" for the First Time While Carving Out an Exemption for Charges Imposed for the Use of Local Government Property 28

III. APPELLANTS' INTERPRETATION OF *JACKS* WOULD UNDERMINE CITIES' AUTHORITY TO LEVERAGE PUBLIC PROPERTY BY EXACTING MARKET VALUE FRANCHISE COMPENSATION IN EXCHANGE FOR FRANCHISE RIGHTS 32

A. In *Jacks*, the Supreme Court Established A Method for Evaluating Franchise Value based on Bona Fide Arms-Length Negotiations between a City and a Utility 32

B. The Supreme Court in *Jacks* did not Impose Additional Burdens of Proof on the City 34

1. The Supreme Court in *Jacks* does not Require Lower Courts to Evaluate the Value Received in Exchange for Franchise Compensation through the Lens of the Ratepayers who Eventually Bear the Incidence of the Charge 34

2. *Jacks* does not Require that Ratepayers' Interests be Represented in Franchise Negotiations for those Negotiations to Serve as Evidence that the Franchise Compensation Bears a Reasonable Relationship to the Value of the Franchise Rights..39

C. Appellants' Proposal for Exacting Scrutiny of Franchise Compensation would Severely Restrict Cities' Traditional Ability to Negotiate for and Command Maximum Franchise Compensation...............42

CONCLUSION..44

CERTIFICATE OF COMPLIANCE WITH RULE 8.204(C)(1)...........46

TABLE OF AUTHORITIES

<u>Cases</u>

Amador Valley Joint Union High Sch. Dist. v. St. Bd. of Equalization,
22 Cal.3d 208 (1978) 24

Citizen Ass'n of Sunset Beach v. Orange County Local Agency Formation Com., 209 Cal.App.4th 1182 (2012) 31

City and Cnty of San Francisco v. Market St. Ry. Co.,
9 Cal.2d 743 (1937) 17

City of Madera v. Black,
181 Cal. 306 (1919) 31

City of Oakland v. Hogan,
41 Cal.App.2d 333 (1940) 17

Cnty of Kern v. Pac. Gas & Elec. Co.,
108 Cal.App.3d 418 (1980) 20

Cnty of Los Angeles v. Sasaki,
23 Cal.App.4th 1442 (1994) 25

Cnty of Sacramento v. Pac. Gas & Elec. Co.,
193 Cal.App.3d 303 (1987) 16

Copt-Air v. City of San Diego,
15 Cal.App.3d 984 (1971) 17

Greene v. Marin Cnty Flood Control & Water Conservation Dist.,
49 Cal.4th 277 (2010) 27

Howard Jarvis Taxpayers Ass'n v. Bay Area Toll Auth.,
51 Cal.App.5th 435, ___ (2020) 18, 34

In re Cnty Tel. Serv. Cases,
48 Cal.App.5th 354 (2020) 40

Jacks v. City of Santa Barbara, 3 Cal.5th 248 (2017) .... passim

Knox v. City of Orland,
4 Cal.4th 132 (1992) 27

Pac. Tel. & Tel. Co. v. City and Cnty of San Francisco,
197 Cal.App.2d 133,(1961) 16

Ponderosa Homes, Inc. v. City of San Ramon,
23 Cal.App.4th 1761 (1994).. 31

Santa Barbara Cnty Taxpayer Ass'n v. Bd. of Supervisors,
209 Cal.App.3d 940 (1989) 16, 17

Santa Clara County Local Transp. Auth. v. Guardino,
11 Cal.4th 220 (1995) 26

Schmeer v. Cnty of Los Angeles,
213 Cal.App.4th 1310 (2013)... 28, 31

Sinclair Paint Co. v. State Board of Equalization,
15 Cal.4th 866 (1997) 28, 29

S. Cal. Gas Co. v. Pub. Util. Comm'n,
23 Cal.3d 470 (1979)... 20

Southern Pac. Pipe Lines, Inc. v. City of Long Beach,
204 Cal.App.3d 660 (1988) 19

Tulare Cnty v. City of Dinuba,
188 Cal. 664 (1922)... 16

Zolly v. City of Oakland,
47 Cal.App.5th 73 (2020).. 18, 34

Constitutional Provisions

Cal. Const., art. XIII A, § 1 .... 23, 24

Cal. Const., art. XIII A, § 2. 24

Cal. Const., art. XIII A, § 4 24

Cal. Const., art. XIII C, § 1 26

Cal. Const., art. XIII C, § 1(e) 30, 31

Cal. Const., art. XIII C, § 2 .... 24, 26

Cal. Const., art. XIII C, § 3 24

Cal. Const., art. XIII D, § 2(b) 27

Cal. Const., art. XIII D, § 2(d) 27

Cal. Const., art. XIII D, § 4 27

Cal. Const., art. XIII D, § 5 27

Cal. Const., art. XIII D, § 6 27

Cal. Const., art. XIII D, § 6(a)(2) 27

Cal. Const., art. XIII D, §6(b) 27

Statutes

1937 Franchise Act, Cal. Pub. Util. Code § 6201 et seq. 19

Broughton Act, 1905 Cal. Stats. ch. 578 .... 18, 19

Cal. Gov. Code § 53721 26

Regulations

Investigation on the Commission's own motion to establish guidelines for the equitable treatment of revenue-producing mechanisms imposed by local government entities on public utilities, Dec. 89-05-063, Inv. 84-05-002 at 63 (May 26, 1989) *passim*

Other Authorities

Michael Coleman, *The California Municipal Revenue Sources Handbook* (5th ed. 2019) 43

APPLICATION OF THE LEAGUE OF CALIFORNIA CITIES TO FILE AMICUS CURIAE BRIEF IN SUPPORT OF RESPONDENT CITY OF SANTA BARBARA

The League of California Cities, in accordance with Rule 8.200(c) of the California Rules of Court, respectfully requests permission to file the accompanying amicus curiae brief in support of the Defendant and Respondent City of Santa Barbara in this appeal.

The League of California Cities is an association of 476 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, 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 or nationwide significance. The Committee has identified this case as having such significance.

The League and its member cities have a substantial interest in the outcome of this appeal. The appeal seeks reversal of the trial court's order on remand (a) upholding the constitutionality of the City of Santa Barbara franchise compensation structure; and (b) ruling that the portion of the compensation supported by the surcharge is not a tax under Proposition 218. The lower court concluded that the entire franchise compensation paid by SCE to the City, including the component recovered from ratepayers through a surcharge, bears a reasonable relationship to the value of the franchise rights as required by *Jacks*.

Appellants contend that because SCE recovers the cost of the franchise compensation through a surcharge imposed on ratepayers, this Court must analyze the "value" utility customers receive for their payment of the surcharge. A decision by this Court adopting Appellants' position will make it more difficult for cities to command and collect franchise and similar compensation. The impact on this important source of municipal revenue could be substantial.

Appellants' position jeopardizes the longstanding ability of cities to command franchise compensation from utilities that reflects the considerable value of the franchise right to operate a for-profit utility in the jurisdiction. Such compensation is common throughout the state and has remained a vital source of funding for cities to use to fund core government services. The right of a city to command franchise compensation is supported by over one hundred years of franchise jurisprudence and exists despite over 40 years of voter-driven initiatives aimed at restricting local revenues. According to the November 1, 2016 edition of *Western City,* a significant portion of all unrestricted city revenues available to California cities is attributable to franchise compensation.[1] Coleman, *A Primer on California City Revenues, Part One: Revenue Basics* (November 1, 2016) *Western City.*

---

[1] Franchise compensation pays for a broad range of core government services provided by cities, including, law enforcement, animal control, fire protection, parks, recreation, public works, planning and land use, water, wastewater, solid waste, library services, arts, housing assistance, infrastructure and economic development. The demands on California cities continue to increase with the costs of public pension obligations, stormwater and environmental compliance requirements and other new regulations.

California voters have enacted significant constitutional provisions limiting local revenues. Such legislation does not address the amounts cities can command as franchise compensation which is generally the product of negotiated agreements. Appellants' argument that an additional level of scrutiny should be applied to franchise compensation is not found in the California Constitution, but is based on Appellants' misreading of *Jacks v. City of Santa Barbara*, 3 Cal.5th 248 (2017). Appellants' restrictive reading of *Jacks* would put vital municipal revenue at risk. However, *Jacks* does not impose the level of scrutiny suggested by Appellants. Instead, the Supreme Court in *Jacks* gave lower courts wide berth in determining franchise value issues.

The League wishes to assist this Court in understanding the historical basis for cities' reliance on franchise compensation and the importance of franchise compensation to the stability of California cities' finances. The League believes its perspective on this matter is worthy of the Court's consideration and will assist the Court in deciding this matter. The League's counsel has examined the briefs on file in this case and is familiar with the issues involved and the scope of their presentation. In this brief, the League does not seek to duplicate that briefing. 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 *amicus curiae* brief.

No party or counsel for a party in this appeal authored any part of the accompanying *amicus curiae* brief. No person or entity other

than the League and its attorneys in this matter made any monetary contribution to fund preparation of this brief.

Dated: August 7, 2020

MARA W. ELLIOTT, City Attorney

By *Is/ Meghan Ashley Wharton*
Meghan Ashley Wharton
Senior Deputy City Attorney
City of San Diego

Attorneys for Amicus Curiae
LEAGUE OF CALIFORNIA CITIES

BRIEF OF AMICUS CURIAE
LEAGUE OF CALIFORNIA CITIES

INTRODUCTION

California cities provide core government services and infrastructure to the public, including law enforcement, streets and sidewalks, fire stations, libraries, planning and land use, water, wastewater, stormwater, solid waste, arts support, housing assistance and economic development. Cities provide these services and infrastructure to the public in order to enhance the quality of life for residents and visitors, protect the vulnerable and preserve the health and safety of everyone in the City.

California cities also own property, including the streets, sidewalks and public rights-of-way. Cities manage the property for the public benefit. Cities leverage their ownership of this property for the public good by granting private, for-profit utility companies the right to use it to provide utility service to residents, visitors, and businesses and charging utilities for that use.

Over the past four decades, California voters have repeatedly limited local sources of revenue by expanding voter approval requirements for the imposition of taxes, fees and charges. *Jacks*, 3 Cal.5th at 258. While California voters enacted measures to restrict local government revenues, the voters left intact the right and ability of a city to command compensation from a utility for the right to operate in the City's rights-of-way. This is because franchise compensation is the product of a contract between sophisticated and capable parties after what can be years of protracted negotiations over countless terms,

including how to fairly compensate a city for both the possessory interest in the city's rights of way and the special privilege to use city property to transact business with residents in the city.

Under California law, a utility is entitled to recover the full cost of the franchise compensation paid to a city from ratepayers. For the most part, the expense of franchise compensation is buried in the rates the utility charges all ratepayers in the utility's service area. In this instance, the amount of franchise compensation SCE was required to pay to the City exceeded the average of the franchise compensation SCE pays to all cities in its service area. Therefore, pursuant to a decision of the California Public Utilities Commission (PUC), SCE applied to the PUC to use a surcharge to pass through the cost of the additional franchise compensation to only ratepayers in the City.

The amount of franchise compensation paid to a city is lawful if the amount bears a reasonable relationship to the value of the franchise rights conveyed to the utility. *Jacks*, 3 Cal.5th at 269. In this case, after years of negotiations, the City and SCE entered into a franchise agreement pursuant to which SCE agreed to pay compensation of 2 percent of its gross receipts from City customers to the City in exchange for the franchise rights. On remand, the trial court examined the total franchise compensation to determine if it bore a reasonable relationship to the value of the property interest conveyed in the franchise agreement, as *Jacks* instructs. Against the argument of Appellants, the lower court examined the entirety of the franchise compensation, including the component recovered through the surcharge, under this test. The lower court determined that the amount

of the franchise compensation bore a reasonable relationship to the value of the property interest and franchise rights conveyed to the City. [15 AA 3396-97.]

Appellants argue that this Court should use a far more exacting standard to determine whether there is a reasonable relationship between the franchise compensation paid by SCE and the value of the franchise rights SCE obtained. However, as explained in detail herein, Appellants' argument for a more exacting standard is not supported by the Supreme Court's decision in *Jacks*. In fact, in *Jacks*, the Supreme Court had the opportunity to adopt Appellants' restrictive test and chose not to because to do so would be "placing form over substance." *Jacks*, 3 Cal.5th at 269.

If this Court were to adopt Appellants' interpretation of *Jacks*, the effect on California cities would be significant. In the face of strict restrictions on city revenue, such a reading of *Jacks* would open franchise agreements between utilities and charter cities across the state to litigation. Such a reading would also undermine the result of negotiations that took place years in the past and thereby disrupt city revenue streams. Finally, such a reading would further strip cities of local control over revenue in a manner not contemplated by Propositions 13, 218 and 26.

STATEMENT OF FACTS

The League adopts the Statement of Facts as set forth in the City of Santa Barbara's April 22, 2020 Respondent's Brief (RB 13-17).

PROCEDURAL HISTORY

The League adopts sections I and III of the Procedural History as set forth in the City of Santa Barbara's April 22, 2020 Respondent's Brief (RB 17-18, 24-28).

ARGUMENT

I. A CITY RECEIVES COMPENSATION FROM A UTILITY IN EXCHANGE FOR FRANCHISE RIGHTS

A. California Cities Generate Revenue for Government Services by Charging Utilities for Franchise Rights

A franchise is a grant of a possessory interest in public real property, similar to, but not the equivalent of, an easement or a leasehold over the public entity's rights-of-way. *Pac. Tel. & Tel. Co. v. City and Cnty of San Francisco*, 197 Cal.App.2d 133, 154 (1961); *Santa Barbara Cnty Taxpayer Ass'n v. Bd. of Supervisors*, 209 Cal.App.3d 940, 949 (1989) ("*Santa Barbara*"). Franchise agreements are negotiated contracts between investor-owned, for-profit utility companies and cities that own public rights-of-way in the utility's service area. *Tulare Cnty v. City of Dinuba*, 188 Cal. 664, 669 (1922). In exchange for the grant of the right to use the public streets and city rights-of-way to provide utility service to ratepayers—the franchise rights—a utility pays compensation to the city. *Cnty of Sacramento v. Pac. Gas & Elec. Co.,* 193 Cal.App.3d 303, 305 (1987) (noting that the obligation to pay under a franchise agreement is contractual in nature and not an obligation imposed by law), *City and Cnty of San Francisco v. Market St. Ry. Co.*, 9 Cal.2d 743, 749 (1937) (noting that the "price" of the franchise can be set in a variety of ways including as a lump sum

or as a percentage of the gross receipts during the term of the franchise). Franchise agreements govern many aspects of the relationship between the utility and the city.

The compensation a city receives in exchange for the grant of franchise rights under the terms of a franchise agreement constitutes compensation for not only the use of city property but also compensation for the often exclusive right to use that property to transact business, provide services and operate a public utility as a for-profit business within the territorial boundaries of the city. *City of Oakland v. Hogan*, 41 Cal.App.2d 333, 346-47 (1940). The grant of franchise rights includes "a special privilege conferred upon a corporation or individual by a government duly empowered to grant it." *Copt-Air v. City of San Diego*, 15 Cal.App.3d 984, 987 (1971).

The compensation paid by the utility to a city in exchange for the franchise rights is similar to rent. *Santa Barbara*, 209 Cal.App.3d at 949. In most instances, this "rent" is general revenue for the city and is used by the city to provide services to the general public. *Jacks*, 3 Cal.5th at 254 (noting that franchise rights are a property interest and that a city has the authority to sell or lease its property and spend the compensation it receives in return for whatever purposes it chooses). However, California law does not restrict a city's ability to designate franchise compensation for a specific use. *Id.*

California law requires cities to command the highest level of compensation that the market will support as "rent" for franchise rights. *Jacks,* 3 Cal.5th at 269-70 (noting that the franchise compensation must be based on the market value of the franchise

rights conveyed to the utility). As with any agreement to let public property, the city charges the negotiated market value for the franchise rights, not the amount of the entity's costs associated with maintaining the franchise. *Jacks*, 3 Cal.5th at 271-72; *See* Cal. Gov't Code § 25530 (permitting counties to rent property based on the highest bid); *see also Howard Jarvis Taxpayers Ass'n v. Bay Area Toll Auth.*, 51 Cal.App.5th 435, ___ n.18 (2020) (concluding that franchise compensation can qualify for the exception to the definition of tax for the purchase, rental or lease of government property without a city proving a nexus between the amount of the franchise compensation and the reasonable cost of providing the franchise rights); *contra Zolly v. City of Oakland*, 47 Cal.App.5th 73, 88 (2020).

B. Charter Cities Lawfully Command More Compensation from Utilities for Franchise Rights than General Law Cities

Historically, California law has taken several different approaches to the amount of compensation a utility is required to pay a city in exchange for franchise rights. In 1905, the Legislature enacted the Broughton Act authorizing cities to enter into franchise agreements with utilities relating to the provision of services not covered by the "constitutional franchise." 1905 Cal. Stats. ch. 578, p. 777. The Broughton Act also established procedures for public auction of franchise rights and a formula for computing franchise compensation. 1905 Cal. Stats. Ch. 578, p. 777 at PUC §§ 6001, 6005-6007. Under the formula established by the Broughton Act, if a utility held a constitutional franchise, a city could charge up to 2 percent of the

utility's gross annual receipts as compensation for the franchise rights. 1905 Cal. Stats. ch. 578, p. 777 at PUC § 6006.

The Legislature eventually supplemented the Broughton Act with the 1937 Franchise Act. Cal. Pub. Util. Code § 6201 et seq. The 1937 Franchise Act set franchise compensation paid by a utility to a city as 2 percent of the franchisee's receipts from use of the franchise within the city or one percent of gross annual receipts from sales within the jurisdiction. Cal. Pub. Util. Code § 6231(c). The Broughton Act and the 1937 Franchise Act continue to govern general law cities' franchise compensation, and most utilities pay 1% of their gross annual receipts within a city's borders.

California charter cities have constitutional authority to exceed the limits of the Broughton Act and the 1937 Franchise Act. Cal. Pub. Util. Code §§ 6001, 6205; *Jacks*, 3 Cal.5th at 265, *Southern Pac. Pipe Lines, Inc. v. City of Long Beach*, 204 Cal.App.3d 660, 669-70 (1988) (holding that general law allows chartered cities to adopt home-rule franchise regulations). Further, the Legislature carefully preserved local autonomy as to franchises to ensure that franchise compensation continues to provide funding for local services. *See e.g.*, Cal. Pub. Util. Code § 6350 et seq. (imposing a surcharge on utilities operating in city rights-of-way to replace franchise compensation lost to regulatory changes). As a result, subject to the constitutional and statutory provisions discussed herein, franchise compensation to charter cities and other franchise terms are negotiated between a charter city and the utility and approved by ordinance – a legislative act that is subject to referendum – without interference from the State. *Cnty of Kern v.*

Pac. Gas & Elec. Co., 108 Cal.App.3d 418, 421 (1980). Thus, utilities often pay franchise compensation to charter cities that exceeds the average of about 1% paid to general law cities.

C. Utilities Recover the Expense of Franchise Compensation from Ratepayers; Above-Average Franchise Compensation Paid to Charter Cities May Require a Surcharge

As explained in *Jacks*, a utility is entitled to fully recover its costs and expenses of operating the utility from ratepayers in the utility's service area, including costs and expenses for government charges such as franchise compensation. *Jacks*, 3 Cal.5th at 266 (citing *S. Cal. Gas Co. v. Pub. Util. Comm'n*, 23 Cal.3d 470, 474-76 (1979)). Generally, investor-owned utilities charge all customers within their service area — which can include dozens of cities — a common rate, and their costs for the expense of franchise charges are 'buried' in the rate structure for the utility's entire service area. *Jacks*, 3 Cal.5th at 266 (citing *Investigation on the Commission's own motion to establish guidelines for the equitable treatment of revenue-producing mechanisms imposed by local government entities on public utilities,* Dec. 89-05-063, Inv. 84-05-002 at 63 (May 26, 1989) (*1989 PUC Decision*)).

To protect customers in lower-fee areas, PUC regulations prohibit utilities from burying higher franchise fees charged by charter cities in their base rates paid by all ratepayers in the utility's service area. *Jacks*, 3 Cal.5th at 265-66. In the *1989 PUC Decision*, the PUC found that allowing the utility to bury the additional compensation paid to charter cities in the base rates would cause the utility's cost of paying

the charter cities more compensation to be recovered from *all* ratepayers in the utility's service area. *Id.* (citing the *1989 PUC Decision* at p. 63). The PUC considered this to be inequitable to the ratepayers in the general law cities because they do not benefit from the higher compensation the utility is required to pay to the charter cities. *Id.*

In the *1989 PUC Decision*, the PUC established a surcharge process to allow utilities to recover from customers in a charter city higher-than-average charges (including franchise fees and local taxes) rather than spreading the excess over the general ratepayer body. *Jacks*, 3 Cal.5th at 266-67 (discussing *1989 PUC Decision* at p. 73). The *1989 PUC Decision* standardizes what had been an earlier ad hoc practice to allow utilities to use a line item surcharge on ratepayer bills to segregate and pass through to local ratepayers costs to meet certain utility franchise payment obligations and other above average local fees paid to certain charter cities. *Id.* at 63 n.3.

As explained in detail in *Jacks*, pursuant to the *1989 PUC Decision*, when a charter city imposes franchise compensation obligations on a utility that are higher than the average of such obligations in the utility's service area, the utility may file an advice letter seeking approval from the PUC to include a surcharge as a separate line item on the bills of the ratepayers in the city. *Jacks,* at 267. This is the process the City and SCE used to recover the above-average franchise compensation the City required of SCE in exchange for the franchise rights. *Id.* at 255-56. The result of that process is the surcharge at issue in this action.

However, as noted by the Supreme Court in *Jacks*, the *1989 PUC Decision* "does not concern the validity of any charges imposed by local government." *Id.* at 267. As explained in the 1989 PUC Decision, the PUC did:

> not dispute or seek to dispute the authority or right of any local government entity to impose or levy any form of tax or fee upon utility customers or the utility itself, which that local entity, as a matter of general or judicial decision, has jurisdiction to impose, levy, or increase. Any issue relating to such local authority is a matter for the Superior Court, not this Commission.

1989 PUC Decision, at 69.

II. OVER THE PAST FORTY YEARS VOTERS ENACTED RESTRICTIONS ON LOCAL REVENUE MEASURES BUT FRANCHISE COMPENSATION REMAINED UNTOUCHED AS AN IMPORTANT SOURCE OF CITY REVENUE TO FUND CORE GOVERNMENT SERVICES

Over the last forty years, California voters have significantly limited and restricted city revenues. The consequences for cities' ability to maintain the same levels of core government services have been significant. Cities no longer have presumed legislative authority and deferential review over their revenue measures. Rather, cities operate under the presumption that voter approval is required to fund core government services and that cost of service limitations apply.

Noticeably absent from voter efforts to restrict city revenue is any attempt to restrict cities' ability to leverage public property for revenue purposes, including cities' ability to command franchise compensation in exchange for exclusive rights to use the city's property to provide utility services. In fact, voters have made no efforts to limit such

compensation despite many opportunities to do so. As a result, cities have come to rely on franchise compensation as a stable component of municipal revenue that is vital to cities' ability to fund core government services.

A. Proposition 13 Significantly Reduced Cities' Discretionary Revenue and Restricted the Adoption of Special Taxes but did not Restrict Cities' Ability to Leverage Public Property for Compensation, Including Franchise Compensation

Prior to 1978, property tax revenue was the primary source for funding core government services in California cities. In 1974, America experienced rapid inflation and economic stagnation, driving residential property prices up rapidly causing a corresponding increase in the assessed valuations for property tax purposes. In light of these economic conditions, California voters approved Proposition 13 in 1978. Proposition 13 was intended to provide financial relief to California property owners and taxpayers through a package consisting of real property tax rate limitations (Cal. Const., art. XIII A, § 1), a real property assessment limitation (Cal. Const., art. XIII C, § 2), a restriction on state taxes (Cal. Const. art. XIII C, § 3) and a restriction on local taxes (Cal. Const., art. XIII A, § 4).

Proposition 13 set the assessed value of real property as the "full cash value" on the owner's 1975-1976 tax bill, limited increases in the assessed value to 2 percent per year unless there was a change in ownership and limited the rate of taxation on real property to 1 percent of its assessed value. Cal. Const., art. XIII A, §§ 1, 2. To ensure that tax

savings accrued to real property owners, Proposition 13 required two-thirds approval of the Legislature to increase state taxes and two-thirds approval of the local electors of a city, county or special district in order to impose special taxes. Cal. Const., art. XIII A, §§ 3, 4. Proposition 13's constitutionality was challenged and ultimately upheld, paving the way for its limitations to take effect as to local taxes on July 1, 1979. *Amador Valley Joint Union High Sch. Dist. v. St. Bd. of Equalization,* 22 Cal.3d 208, 219 (1978).

In addition to limiting cities' portions of property tax revenue, Proposition 13 further restricted the ability of cities to adopt "special taxes" without first obtaining two-thirds voter approval. Cal. Const., art. XIII A, § 4. The Legislature subsequently adopted Government Code section 50076 in 1979 to provide some guidance on identifying the sorts of fees and charges generally exempt from the definition of a special tax, including "any fee which does not exceed the reasonable cost of providing the service or regulatory activity for which the fee is charged and which is not levied for general revenue purposes."

Proposition 13's impact on cities was profound. It converted hundreds of locally-imposed property tax rates of differing amounts to a statewide rate of 1 percent of the full cash value of the real property assessed. Among other things, this resulted in a one-half statewide reduction in property tax revenues used by cities to fund core government services. *Cnty of Los Angeles v. Sasaki,* 23 Cal.App.4th 1442, 1451 (1994) (*Sasaki*). In *Sasaki*, the Court of Appeal recognized that the "purpose of Proposition 13 was to cut local property taxes. Its effect was to drastically cut property tax revenue, and thereby sharply

reduce the funds available from that source to local governments, and also schools." *Id.* (citations omitted).

Proposition 13 substantially impacted cities throughout the State by: (a) drastically reducing property tax and assessment revenue available to cities to fund core government services; and (b) placing new voter-approval requirements for taxes to generate replacement revenue. Proposition 13 had a significant financial impact and resulted in a permanent overall reduction in revenue available to cities to fund core government services.

Proposition 13 did not limit the ability of cities to leverage public property for compensation, including the ability of a city to command franchise compensation for a utility's use of city rights-of-way and associated franchise rights.

B. Proposition 62 Limited Cities' Authority to Impose General and Special Taxes, but did not Limit a City's Authority to Leverage Public Property for Compensation, Including Franchise Compensation

Less than a decade later, in 1986, California voters approved Proposition 62. Proposition 62 amended the California Government Code to provide that "all new local taxes be approved by a vote of the local electorate." *Santa Clara County Local Transp. Auth. v. Guardino,* 11 Cal.4th 220, 231 (1995). Proposition 62 recognized that if special taxes were taxes imposed for a "specific purpose," a definition for "general tax" was needed. As such, Proposition 62 declared that all taxes are "either general or special" and defined a "general tax" to be a tax imposed for "general governmental purposes." Cal. Gov. Code §

53721. Proposition 62 further provided specific procedures and requirements applicable to the calling of an election to authorize taxes.

As was the case with Proposition 13, nothing in Proposition 62 indicated voter intent to regulate or limit the ability of cities to leverage public property for compensation, including the ability of a city to command franchise compensation for a utility's use of city property and associated franchise rights.

C. Proposition 218 Reaffirmed the Voter Assent Requirements for Taxes and Imposed Rigorous Procedural Requirements for Property-Related Fees, Charges and Assessments but did not Impact Cities' Ability to Leverage Public Property for Compensation, Including Franchise Compensation

In 1996, California voters approved a sweeping constitutional amendment known as Proposition 218 to further limit local government revenue. Proposition 218 amended the Constitution relating to voter approval requirements for general and special taxes and made them applicable to all public entities, including general law and charter cities. Cal. Const., art. XIII C, §§ 1, 2. Additionally, Proposition 218 limited traditional benefit assessments left largely unchecked by Proposition 13. *Knox v. City of Orland,* 4 Cal.4th 132, 141 (1992); *Greene v. Marin Cnty Flood Control & Water Conservation Dist.*, 49 Cal.4th 277, 284 (2010).

Proposition 218 created new procedural and substantive requirements that a city must comply with prior to increasing, extending, or adopting a new property-related fee, charge or benefit assessment. Cal. Const., art. XIII D, §§ 4-6. With respect to

assessments, for example, a city must meet procedural and substantive requirements before extending, increasing or imposing a new assessment. Cal. Const., art. XIII D, § 2(b). Substantively, Proposition 218 mandated that the benefit assessment may only be imposed, and must be proportionate to, special benefits conferred upon a parcel. Cal. Const., art. XIII D, § 2(d).

Similarly, prior to adopting new or increasing existing property-related fees or charges, a city must hold a noticed public hearing. Cal. Const., art. XIII D, § 6(a)(2). Substantively, a property-related fee or charge must not exceed the revenues necessary to provide the property-related service for which the charge is imposed, must be proportionate to the cost of providing that service on a parcel basis, and may only be used for the purpose of providing that service. Cal. Const., art. XIII D, §6(b).

As was the case with Propositions 13 and 62, "[n]othing in Proposition 218 reflects an intent to change the historical characterization of franchise fees, or to limit the authority of government to sell or lease its property and spend the compensation received for whatever purposes it chooses." *Jacks*, 3 Cal.5th at 262. Had the California voters wished to regulate the contracting authority of cities entering into franchise agreements for negotiated franchise compensation, such an intent would have been apparent from the text of Proposition 218 or the ballot materials for the provision.

D. Proposition 26 Defines the Term "Tax" for the First Time While Carving Out an Exemption for Charges Imposed for the Use of Local Government Property

In 2010, California voters once again restricted city revenues with the adoption of Proposition 26. Proposition 26 was adopted largely in response to judicial interpretation of Proposition 13 and 218. *Schmeer v. Cnty of Los Angeles*, 213 Cal.App.4th 1310, 1322 (2013). Prior to Proposition 26, courts generally upheld regulatory fees that were imposed in an amount necessary to carry out the purposes and provisions of the regulation, did not exceed the reasonable cost of providing the services necessary to the activity on which the fees are based, and were not levied for an unrelated revenue purpose. *Id*. at 1321-22 (discussing *Sinclair Paint Co. v. State Board of Equalization,* 15 Cal.4th 866 (1997)).

For example, in *Sinclair Paint*, the California Supreme Court considered a state fee imposed on makers of lead-containing consumer products imposed on manufacturers of such products to mitigate the environmental and public health consequences of lead exposure. *Sinclair Paint*, 15 Cal.4th at 871-72. The fee required manufacturers to bear a fair share of the cost of mitigating the adverse health impacts of using lead in their products, without the manufacturer receiving any special benefits or service as a result of paying the fee. *Id.* The California Supreme Court found that such fees could be imposed under the state's police powers as compensation for the burden the fee payor imposes on society as a whole. *Id.* at 875-876. The Supreme Court specifically reasoned that such fees need not confer benefits or

privileges on the fee payor (paint manufacturers) directly, provided the fee bears a reasonable relationship to the burden the paint manufacturers imposed on society. *Id.*

The voters adopted Proposition 26 in an effort to limit the ability of local governments to impose the type of fee authorized by *Sinclair Paint.* Proposition 26 definitively and broadly defines the term "tax" by amending article XIII A, section 3 of the California Constitution (adopted by Proposition 13 and relating to state taxes), and article XIII C, section 1 (adopted by Proposition 218 and relating to local taxes). With respect to local fees and charges, article XIII C, section 1(e) was added to the Constitution to define every fee or charge of any kind as a tax, unless explicitly (or implicitly) exempt. Explicit exemptions include:

> (1) a charge imposed for a specific benefit or privilege received only by those charged, which does not exceed its reasonable cost,
>
> (2) a charge for a specific government service or product provided directly to the payor that is not provided to those not charged, which does not exceed its reasonable cost,
>
> (3) charges for reasonable regulatory costs related to the issuance of licenses, permits, investigations, inspections, and audits, and the enforcement of agricultural marketing orders,
>
> (4) a charge imposed for entrance to or use of local government property, or the purchase, rental, or lease of local government property;
>
> (5) fines for violations of law,
>
> (6) charges imposed as a condition of developing property, and

(7) property-related assessments and fees as allowed under article XIII D.

Cal. Const., art. XIII C, § 1(e).

Notably, Proposition 26's fourth exemption applies to a fee or charge "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(e)(4). Unlike the three preceding exemptions, no limitations or restrictions requiring the charges for use of local governmental property to reflect the reasonable costs of service were put in place by the voters in enacting exemption number four. Cal. Const., art. XIII C, § 1(e)(1)-(3). Therefore, the government property exception does not include a requirement that the charge for the entrance or use of local government property not exceed the reasonable costs related to the government's ownership of the property. Cal. Const., art. XIII C, § 1(e)(4).

Additionally, by its very language, Proposition 26 and the limitations on local revenue only apply to the extent a fee or charge is "imposed" by a local government. Cal. Const., art. XIII C, § 1(e). While Proposition 26 does not define the term "impose," case law has generally required some element of coercion existing outside of the realm of a contractual negotiation or voluntary payment. When analyzing different fees and charges, courts have looked to the dictionary definition of the term "impose" to apply where a fee is established or applied by authority or force. *Ponderosa Homes, Inc. v. City of San Ramon,* 23 Cal.App.4th 1761, 1770 (1994) (citing Webster's

Third Int'l Dictionary (1970) to construe "impose" as used in the Mitigation Fee Act); *City of Madera v. Black,* 181 Cal. 306, 314–315 (1919) (sewer rates are "imposed" because they were adopted without consent of payors and payment is compulsory); *Citizen Ass'n of Sunset Beach v. Orange County Local Agency Formation Com.,* 209 Cal.App.4th 1182, 1194 n.15 (2012) (citing Black's Law Dictionary and Oxford English Dictionary to construe Prop. 218).

Similarly, the Court of Appeal in *Schmeer*, 213 Cal.App.4th at 1326–1327, noted that in ordinary usage, "tax" refers to a "compulsory payment" to a government. *Schmeer* involved a challenge to a county ordinance barring the practice of giving free plastic bags at retail outlets and requiring retailers to charge $0.10 for paper bags—which the retailer collected and retained. The ten-cent fee was not subject to Proposition 26 because it was not paid to the government and therefore was not a "levy, charge, or exaction of any kind imposed by a local government." *Id.* at 1328-29. Similarly, franchise compensation paid by a utility to a city pursuant to an arm's length franchise agreement negotiated between the city and the utility likewise lacks the coercive nature of fees subject to Proposition 26.

Proposition 26 was the culmination of voter-driven statutory and constitutional restrictions on local revenues. Despite the significant restrictions these laws and constitutional provisions imposed on local revenue, the voters did not interfere with or limit the ability of cities to leverage public property for compensation, including the ability of a city to command franchise compensation for a utility's use of city

property and the associated right to operate a for-profit utility in the city's jurisdiction.

III. APPELLANTS' INTERPRETATION OF *JACKS* WOULD UNDERMINE CITIES' AUTHORITY TO LEVERAGE PUBLIC PROPERTY BY EXACTING MARKET VALUE FRANCHISE COMPENSATION IN EXCHANGE FOR FRANCHISE RIGHTS

A. In *Jacks*, the Supreme Court Established A Method for Evaluating Franchise Value based on Bona Fide Arms-Length Negotiations between a City and a Utility

The Supreme Court in *Jacks* held that Proposition 218 does not limit a city's ability to leverage government property for compensation. *Jacks*, 3 Cal.5th at 262 (noting that "although Proposition 218 imposed additional restrictions on the imposition of assessments, the initiative did not impose additional restrictions on other fees"). The Supreme Court further held that determining whether a charge for the use of government property is lawful—not a tax—requires a court to determine whether the charge bears a "reasonable relationship to the value of the property interest" conferred. *Jacks*, 3 Cal.5th at 254.

Therefore, under *Jacks*, the trial court on remand was required to determine whether the franchise compensation the City receives from SCE bears a reasonable relationship to the value of the property interest and franchise rights that SCE receives from the City under the terms of the franchise agreement. *Id.* Under *Jacks*, if the trial court finds the fee "imposed in exchange for a property interest. . . bear a

reasonable relationship to the value received from the government," the fee is not a tax. *Id.* at 269.

The Supreme Court then established two methods for a city to use to prove that franchise compensation is reasonably related to the value of the property interest and the franchise rights. First, a city can prove that franchise compensation is reasonably related to the value of the property interest and franchise rights by producing evidence demonstrating that the franchise compensation was set through bona fide arm's length negotiations where the utility had an incentive to negotiate a lower fee. *Id.* at 269-70.

In the alternative, a city can prove that the franchise compensation is reasonably related to the value of the property interest and franchise rights by producing evidence demonstrating the value of the property interest and the franchise rights.[2] *Id.*

The Supreme Court in *Jacks* did not include a requirement that the City price the franchise compensation at a rate that matches its costs to provide the franchise rights to SCE. For example, there is no requirement that the City limit its charge for the franchise rights to only the costs that the City will incur in administering the franchise

---

[2] The Supreme Court established this second independent method for evaluating value allowing the lower court to evaluate evidence of "other indicia of value to establish a reasonable value of franchise rights." *Jacks*, 3 Cal.5th at 270. In examining "other indicia of value," the Court may consider both "expert opinion and subsequent case law." *Id.* at 270 n.11. On remand, the trial court did not use this method to support the final ruling that the franchise compensation paid by SCE bears a reasonable relationship to the value of the franchise rights SCE obtained. [15 AA 80:3396-97.]

during the franchise term. *Accord Howard Jarvis*, 51 Cal.App.5th at ___ n.18; *contra Zolly*, 47 Cal.App.5th at 88.

B. The Supreme Court in *Jacks* did not Impose Additional Burdens of Proof on the City

Appellants argue that this Court should use a far more exacting standard to determine whether there is a reasonable relationship between that the franchise compensation paid by SCE and the value of the franchise rights SCE obtained from the City. However, Appellants' argument for a more exacting standard is not supported by the Supreme Court's decision in *Jacks*.

1. The Supreme Court in *Jacks* does not Require Lower Courts to Evaluate the Value Received in Exchange for Franchise Compensation through the Lens of the Ratepayers who Eventually Bear the Incidence of the Charge

Appellants ask the Court to separately analyze the value of the surcharge component of the franchise compensation SCE pays to the City under an exacting standard not contemplated by the Supreme Court in *Jacks*. Appellants argue that the trial court was required to determine whether the surcharge component of the franchise compensation represents the reasonable value of the franchise rights by "determining if there is a relationship between the surcharge imposed on utility users and the lease of City property." [ARB at 9.] Under Appellants' reading of *Jacks*, the City was required to prove that the amount of the surcharge eventually recovered from ratepayers is reasonably related to the value of the franchise rights or other benefits

obtained by the ratepayers. [AOB at 8, 37, 46; ARB at 9-10, 22-23, 41-42.]

However, *Jacks* imposes no such test for analyzing the surcharge component of franchise compensation recovered through a surcharge under the *1989 PUC Decision*. *Jacks* establishes an analytical framework for examining *all* franchise compensation: Does the compensation paid by the utility bear a reasonable relationship to the value of the franchise rights received from a city? Appellants agree that this framework is applicable to the portion of the franchise compensation SCE is permitted to bury in the rates applicable to the entire SCE service area. However, Appellants ask this Court to use an entirely different analytical framework to examine the component of the franchise compensation that SCE recovers via the surcharge in accordance with the *1989 PUC Decision*.

The opinion and ultimate holding in *Jacks* undermine Appellants' argument that the Court should use a different framework for examining the surcharge component of the franchise compensation. While the Supreme Court acknowledged that the eventual burden of paying the surcharge component of the franchise compensation eventually falls on ratepayers, the Court expressly rejected Appellants' argument that the Court is required to consider dispositive the allegation that "the ratepayers do not receive any value in exchange for their payment of the charge." *Jacks*, 3 Cal.5th at 268-69. The Supreme Court further stated that the exact test now proposed by Appellants would effectively place form over substance:

> Because a publicly regulated utility is a conduit through which government charges are ultimately imposed on ratepayers, *we would be placing form over substance if we precluded the City from establishing that the surcharge bears a reasonable relationship to the value of the property interest it conveyed to SCE* because the City expressed in its ordinance what was implicit— that once the PUC gave its approval, SCE would place the surcharge on the bills of customers within the City.

Id. at 269. If the Supreme Court intended subsequent courts to analyze the question of value through the lens of the ratepayers paying the surcharge, the Supreme Court would have said that in *Jacks*. Instead, the Supreme Court rejected such a requirement as improperly "placing form over substance." *Id.*

If this Court adopts Appellants' proposed analytical framework for analyzing franchise compensation recovered from ratepayers through a surcharge, charter cities would effectively be barred from commanding franchise compensation in excess of the average for the utility's entire service area.

As discussed above, California law allows charter cities to command more franchise compensation from utilities than general law cities. *See* section I.B., *infra*. However, when a city commands more than the average franchise compensation in a utility's service area, the utility's costs to recover the additional franchise compensation cannot be buried in the rates applicable to all ratepayers in the utility's service area. See section I.C., *infra*. Therefore, pursuant to the *1989 PUC Decision*, utilities request permission from the PUC to recover the additional franchise compensation due from ratepayers through a

surcharge. *Id.* Effectively, a charter city that wants to collect more than the average franchise compensation paid to general law cities must agree to allow the utility to recover the cost of that additional compensation in the form of a surcharge or risk the utilities refusing payment. *Id.*

Under Appellants' theory of the case, any time that a utility imposes a surcharge to recover the additional cost of franchise compensation owed to a charter city, the Court must analyze the value received in exchange for that component of the franchise compensation through the lens of the ratepayers—not the utility receiving the franchise rights. Such a requirement would have negative consequences for all cities in California.[3]

It may be difficult for a city to prove that the ratepayers are conveyed specific benefits from a city in exchange for paying the surcharge. The primary benefit conveyed in a franchise agreement is the right to use the city's rights-of-way to operate a utility franchise for profit within the city. Clearly, the ratepayers do not receive this primary benefit under the terms of a franchise agreement—the benefit goes to the utility. Instead, the benefits ratepayers receive from

---

[3] For both charter cities and general law cities, the utility buries a portion of the franchise compensation in the base rate. In this case, the Appellants do not challenge the 1 percent portion of the franchise compensation buried in the SCE base rate. However, under Appellants' "ratepayer value" theory even the portion of franchise compensation buried in the base rate would be subject to challenge. For example, plaintiffs could challenge a general law city's franchise compensation on the same grounds by arguing that they do not receive any benefits from the franchise and thus the utility passes its costs for the franchise compensation through to them in the base rate.

franchise agreements are diffuse and difficult to quantify. It would be almost impossible for a city to quantify the value of the benefit to each ratepayer of having electricity service in the city — the benefits of reliable electric service are self-evident, but no electric customer can rely on such service unless the utilities enter agreements with cities to use city rights-of-way to deliver it.

Requiring cities to evaluate the benefits ratepayers receive from their payment of a franchise surcharge separate from the benefit the utility receives presents analytical problems the Supreme Court did not intend in *Jacks*. The PUC requires surcharges to protect customers of investor-owned utilities with service areas covering many cities; the PUC may protect these customers but may not infringe charter cities' rights to charge utilities a market rate to use their rights-of-way to deliver utility service. Without the surcharge as a vehicle for passing the utility's additional cost of franchise compensation owed to charter cities on to ratepayers, charter cities may be unable to command franchise compensation that bears a reasonable relationship to the value of the franchise rights conveyed to the utility, if such compensation exceeds the average franchise compensation paid in the utility's service area — a result *Jacks* did not intend.

/ / /

/ / /

/ / /

/ / /

/ / /

2. *Jacks* does not Require that Ratepayers' Interests be Represented in Franchise Negotiations for those Negotiations to Serve as Evidence that the Franchise Compensation Bears a Reasonable Relationship to the Value of the Franchise Rights

Appellants argue that in order to rely on the good faith bona fide arm's length negotiations between the City and SCE regarding the franchise terms as evidence that the negotiated franchise compensation bears a reasonable relationship to the value of the franchise rights received by SCE, the City must first prove that the interests of the City's electricity ratepayers were represented or protected in the negotiations between the City and SCE. [ARB 28 ("Only if a party involved in the negotiations was actively protecting them based upon an existing, identified incentive, could the negotiations be bona fide and could any alleged connection between the lease and the charge be 'reasonably related.'").]

Appellants argue that because a portion of the franchise compensation will be passed through to ratepayers in the form of a surcharge, the City must prove that the multi-year franchise negotiations between the City and SCE included "incentivized" ratepayers or ratepayer representatives. However, all franchise compensation—along with all other costs of an investor-owned utility—are passed on to ratepayers in the form of rates and surcharges. Therefore, according to Plaintiff's theory, absent ratepayer participation, no franchise negotiations could ever serve as evidentiary

proof that the negotiated franchise compensation bears a reasonable relationship to the franchise rights.

In an analogous situation, Division One of this Court rejected a similar theory on standing grounds. *In re Cnty Tel. Serv. Cases*, 48 Cal.App.5th 354, 367 (2020). *In In re County Telephone*, county jail inmates brought a challenge to high telephone rates that include a component the telephone company pays through to the county, which the inmates argued was a tax. *Id.* at 357. The Court of Appeal held that because the inmates do not pay the charge directly to the county, the inmates lack standing to challenge the telephone rates as including an illegal tax. *Id.* at 367. Of relevance to this case, the Court noted that "no precedents support plaintiffs' claim that a consumer who pays charges to a third party vendor . . . has standing to seek a refund of those charges from the taxing authority." *Id.* Certainly, it would be contrary to the *In re County Telephone* ruling for this Court to rule that the similarly situated Appellants in this case have a right to participate in the negotiations regarding a similar government charge eventually passed on to consumers.

Further, it is not exactly clear how such negotiations would work. For example, would the ratepayers or ratepayer representatives involved in the negotiations have a veto power over franchise terms or compensation amounts they do not agree with? Would franchise agreements become three party agreements involving a city, a utility and a ratepayer group?

Under the Brown Act, Appellants were given notice that the City Council was considering the franchise agreement and an opportunity to

be heard at numerous public meetings. Therefore, the public had ample opportunities to comment on the negotiations. Any ratepayer or ratepayer representative had the ability comment on the franchise agreement, including the surcharge, at these public meetings. The ratepayers were not without the ability to participate in the process.

Appellants seek to impose a burden on the City that was not imposed by the Supreme Court in *Jacks*. *Jacks* does not require the City to make an affirmative evidentiary showing that the interests of ratepayers were adequately represented by an incentivized party in the franchise negotiations. Instead, as explained in *Jacks*, the City need only demonstrate that *SCE* had "an incentive to negotiate a lower fee" and that the negotiations were "bona fide." *Jacks*, 3 Cal.5th at 269-70. The trial court correctly found that the City met this burden.

Imposing a ratepayer participation requirement for franchise negotiations would impose a burden on cities—charter cities in particular who are the primary users of surcharges—not contemplated by *Jacks*. Despite acknowledging that the "cost [of all franchise compensation] is passed on to the ratepayers," the Supreme Court in *Jacks* did not in any way contemplate that ratepayers or ratepayer representatives are therefore entitled (or required) to participate in franchise negotiations. *Id*. at 271-72.

Franchise negotiations involve complex business transactions, and it is not uncommon for the negotiations between a city and the utility to extend over several years. Such negotiations will become unreasonably complicated and possibly unmanageable if they become three party negotiations involving ratepayers. Cities spend valuable

and scarce government resources trying to negotiate franchise agreements that provide benefits for all residents. Yet, while considerable effort is expended to get the agreements right the first time, cities are often required to defend the agreements in court. Including ratepayers in the negotiations will make the process of negotiating an agreement and defending the resulting agreement exponentially more difficult and expensive.

C. Appellants' Proposal for Exacting Scrutiny of Franchise Compensation would Severely Restrict Cities' Traditional Ability to Negotiate for and Command Maximum Franchise Compensation

As described above, as California voters increasingly limited cities' access to revenue to fund core government services through new or increased taxes, fees or assessments, those same voters left cities' ability to generate revenue by commanding compensation for utility franchise rights largely untouched. As a result, franchise compensation has become a key revenue source for California cities. For example, in fiscal year 2015-2016, California cities (excluding the City & County of San Francisco) generated franchise revenue from electric, gas, solid waste and communications franchises exceeding $1.1 billion. *See* Michael Coleman, *The California Municipal Revenue Sources Handbook*, 107 (5th ed. 2019).

Over the past century, California law has afforded nearly unlimited discretion to charter cities to set the franchise compensation a utility must pay and other conditions the utility must meet in order to obtain a franchise to operate a utility within the territorial limits of

the city. Thus, charter cities have been able to negotiate in an effort to obtain the market value for franchise compensation from a utility in exchange for the franchise rights. This process often involves extensive bona fide arms-length negotiations and review at many levels of government to establish the amount of franchise compensation and other conditions for the franchise grant.

As demonstrated by the circumstances of the City of Santa Barbara's franchise agreement with SCE, the final amount of franchise compensation paid by a utility is often the result of intense and time-consuming negotiations that take years to complete. After negotiations are complete, the franchise agreement must go through public vetting before enabling ordinances implement the final franchise agreement.

In this case, the City of Santa Barbara and SCE entered into a series of franchise agreements granting SCE franchise rights to operate an electric utility within the territorial limits of the City of Santa Barbara. Each agreement included a term at the conclusion of which certain conditions of the agreement were renegotiated. Each time the franchise agreement was set to expire, the City of Santa Barbara and SCE were required to renegotiate key terms to ensure, at least for the purpose of franchise compensation, that the amount of franchise compensation represented what the City was willing to accept as well as the amount SCE was willing to pay for the franchise rights. Appellants do not argue the City-SCE agreement was not the result of arms-length negotiations, and the evidence shows the good faith of the negotiations.

The process described in the preceding paragraph is illustrative of the processes charter cities follow to leverage public property to command franchise compensation. The processes often involve intense negotiations between sophisticated knowledgeable parties and culminate in a negotiated agreement which includes, amongst its many terms, franchise compensation obligations. The negotiation process allows cities to receive fair compensation (as established by the market) for the grant of valuable franchise rights.

Interjecting an additional layer of scrutiny, as requested by Appellants, would greatly undermine these established processes. As a result, California cities would be able to obtain far less compensation for franchise rights than the market value of those rights. As *Jacks* suggests, evidence of good-faith, arms-length negotiations — such evidence is unrefuted in this case — should be sufficient to find a franchise fee or surcharge is not a subterfuge for a tax.

CONCLUSION

Franchise compensation is a stalwart of municipal finance, and cities across California rely on it to fund core government services. Franchise compensation has consistently been upheld as compensation for the grant of a possessory interest in government property and associated franchise rights, distinct from taxes or other types of fees and charges.

For over forty years, California voters have acted to restrict local government revenue while at the same time deciding not to interfere with franchise compensation as a source of local government revenue.

Instead, California voters have left the setting of franchise compensation to the discretion of cities.

A city is responsible for negotiating and contracting with a utility regarding the amount of compensation the utility will pay for the right to operate a for-profit utility using the city's rights-of-way. Appellants' position would interject additional levels of judicial scrutiny of these agreements where no such scrutiny is mandated or even suggested under the Supreme Court's decision in *Jacks*. Doing so would put city revenues at risk, would be highly disruptive to the ability of California cities to fund core government services, and would be inconsistent with our voters' decisions to limit the use of some public revenue streams and not others.

Therefore, it is the position of the League that Appellants' request that the Court apply more exacting scrutiny to franchise compensation should be rejected. The Court should affirm the trial court's ruling that the franchise compensation SCE pays to the City bears a reasonable relationship to the value of the property interest and franchise rights obtained under the terms of the franchise agreement.

Dated: August 7, 2020 MARA W. ELLIOTT, City Attorney

By */s/ Meghan Ashley Wharton*
Meghan Ashley Wharton
Senior Deputy City Attorney
City of San Diego

Attorneys for Amicus Curiae LEAGUE OF CALIFORNIA CITIES

CERTIFICATE OF COMPLIANCE WITH RULE 8.204(C)(1)

Pursuant to California Rule of Court 8.204(c)(1), the foregoing Amicus Brief is produced using 13-point Roman type and contains 8,343 words (excluding tables, cover information and certifications) and is thus within the limit of 14,000 words. In preparing this certificate, I relied on the word count generated by Microsoft Word.

Dated: August 7, 2020

MARA W. ELLIOTT, City Attorney

By *_/s/ Meghan Ashley Wharton_*

Meghan Ashley Wharton
Senior Deputy City Attorney
City of San Diego

Attorneys for Amicus Curiae
LEAGUE OF CALIFORNIA CITIES