

No. S224779

SUPREME COURT COPY

**IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA**

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

v.

CITY OF REDDING, et al.
Defendants and Respondents

SUPREME COURT
FILED

AUG 27 2015

Frank A. McGuire Clerk

Deputy

**APPLICATION FOR LEAVE TO FILE AMICUS CURIAE BRIEF
AND PROPOSED AMICUS CURIAE BRIEF OF THE CALIFORNIA
MUNICIPAL UTILITIES ASSOCIATION IN SUPPORT OF
DEFENDANTS AND RESPONDENTS THE CITY OF REDDING**

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

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

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APPLICATION FOR LEAVE TO FILE AMICUS CURIAE BRIEF

The California Municipal Utilities Association (“CMUA”)¹ requests leave to file a brief as *amicus curiae* in this case in support of Respondents, the City of Redding, et al., pursuant to the California Rules of Court, Rule 8.520(f).

INTEREST OF AMICUS

Formed in 1933, CMUA represents the common interests of a coalition of California publicly owned utilities and provides a forum to develop and discuss statewide policy issues affecting its members. CMUA's diverse membership allows it to be a persuasive advocate for the advancement of public policies that mutually benefit its members and the people of the State of California. CMUA advocates on behalf of its members by fostering a better understanding of issues relevant to the

¹ CMUA electric utility members include the Cities of Alameda, Azusa, Banning, Burbank, Cerritos, Colton, Corona, Glendale, Gridley, Healdsburg, Lodi, Lompoc, Los Angeles, Moreno Valley, Needles, Palo Alto, Pasadena, Pittsburg, Rancho Cucamonga, Redding, Riverside, Roseville, Santa Clara, Shasta Lake, Ukiah, and Vernon, as well as the Imperial, Merced, Modesto, and Turlock Irrigation Districts, the Northern California Power Agency, Southern California Public Power Authority, Transmission Agency of Northern California, Lassen Municipal Utility District, Power and Water Resources Pooling Authority, Sacramento Municipal Utility District, the Trinity and Truckee Donner Public Utility Districts, and the City and County of San Francisco, Hetch-Hetchy.

State's publicly owned utilities and disseminating accurate information regarding its members, which include public agencies that provide electricity to approximately 25 percent of Californians.

Many of CMUA's members are cities that operate electric utilities, similar to Redding. As electric utilities are often one of the largest undertakings operating within a city, these local governments would otherwise collect significant tax revenue if a privately owned utility (commonly referred to as an "investor-owned utility") served the city's residents, businesses, and property owners. These funds are instrumental to provide other municipal services that are necessary to support the operation of an electric utility, such as streets, law enforcement, fire protection, and emergency medical services. To address this disparity in funding capacity between cities served by investor-owned utilities and those whose voters have chosen public power utilities, CMUA's city members commonly rely on an operating transfer or a payment in lieu of taxes ("PILOT") to the city's general fund (which finances essential municipal services), which may approximate the revenue that investor-owned utilities pay to their host cities and collect unrecovered costs the host city incurs as consequence of hosting the utility.

This case is of significant importance to CMUA and its members because the positions advocated by Appellants, Citizens for Fair REU Rates, Mr. Michael Schmitz, Ms. Shirlyn Pappas, and Fee Fighter, LLC

(collectively, “Citizens”), would conflict with Proposition 26 and decades-long legally accepted financial practices of several cities with electric utilities. Citizens’ position would inject greater uncertainty into municipal finances and may substantially impair municipal operations by depriving cities of necessary funding to support such utilities, which provide reliable, safe, and affordable power without the necessity of paying returns to private investors. Beyond the impact to PILOTs, failing to grandfather pre-Proposition 26 policies based on the form of the legislation enacting them would disrupt the electric industry. CMUA therefore requests leave to file this amicus brief in support of Redding.

No party other than CMUA and its counsel authored the proposed *amicus* brief in whole or in part or made a monetary contribution to its preparation or submission.

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INTRODUCTION

At issue in this case is Redding's longstanding practice of transferring a specified PILOT from the electric utility to the city. Appellants argue that the adoption of Proposition 26 in 2010 ended Redding's power to do so. However, Redding's Brief persuasively demonstrates that: a) Redding's PILOT charge is not a tax as a matter of law; b) Proposition 26's "reasonable costs of service" exception applies to the PILOT; and c) Redding's PILOT predates Proposition 26 as Proposition 26 does not apply retroactively to charges legislated before its adoption in November 2010. In this Brief, CMUA demonstrates that: (1) operating transfers and PILOTs are common elements of the publicly owned electric industry; (2) the PILOT is not a tax because it predates Proposition 26; and (3) the PILOT reflects reasonable costs of service.

ARGUMENT

I. TRANSFERS TO MUNICIPAL GENERAL FUNDS ARE A COMMON PART OF THE PUBLIC POWER INDUSTRY.

In general, there are two broad models for providing retail electric service used in California: (1) through investor-owned utilities subject to the requirements of the Public Utilities Act (Cal. Pub. Util. Code § 201 *et seq.*) and heavily regulated by the California Public Utilities Commission; or (2) through publicly owned electric utilities that are generally subject to

less comprehensive statutory regulations and are instead regulated by their local elected officials.

As private businesses, investor-owned utilities are subject to various taxes, including property taxes and franchise fees (fees for the use of public rights-of-way). These taxes and fees fund the wide variety of municipal services that enable a private business, such as an electric utility with a large and extensive economic footprint, to function. Where, however, an electric utility is owned and operated by a city, the utility is exempt from these taxes and fees. Despite this exemption, a city operating a power utility incurs the same costs to support the operation of an electric utility, as do neighboring communities served by investor-owned utilities. Streets, police, fire, and other community services are needed for public and private power providers alike. This reality has led to the near universal adoption of some form of transfer from a municipally owned electric utility to the host city's general fund in order to compensate the host city for these otherwise unrecoverable costs. This is true not only in California, but throughout the United States.

The American Public Power Association ("APPA"), the national trade association for municipally owned electric utilities – which includes California utilities – issues a report every two years on the size and types of these contributions. In 2014, APPA released a report titled, "Payments and Contributions by Public Power Distribution Systems to State and Local

Governments, 2012 Data,” as part of their 2014-15 Annual Directory and Statistical Report (“APPA Report”). The APPA Report provides the results of a survey of 210 public power systems throughout the country. (*Id.* at 49). In 2012, the power systems surveyed provided over \$1.0 billion to state and local governments. (*Id.* at 52).

Eighty percent of the utilities surveyed paid some form of transfer, which amounted to over fifty-five percent (\$606,900,000) of the amount those utilities contributed to state and local governments. (*Id.*). There are a variety of industry-accepted methods used to calculate PILOTs. (*Id.* at 52-53). Twenty-eight percent of utilities pay a PILOT calculated as a percentage of gross electric operating revenue, seventeen percent pay a flat amount (often termed an “operating transfer”), and thirteen percent pay a property tax equivalent like that in issue here. (*Id.* at 54). In addition to PILOTs, over fifty-five percent of these publicly owned and operated utilities paid some form of tax, such as gross receipts taxes or property taxes, or franchise fees. (*Id.* at 53).

These transfers are thoroughly integrated in the municipally-owned electric industry. In 2011, Moody’s Investor Service released its “Rating Methodology: U.S. Public Power Electric Utilities with Generation

Ownership Exposure.”² Moody’s methodology to rate the credit-worthiness of America’s public power utilities is based on five factors: (1) cost recovery framework within service territory; (2) willingness to recover costs with sound financial metrics; (3) management of generation risk; (4) rate competitiveness; and (5) financial strength. (*Id.* at 7) One of the key elements of Factor 2 is the relationship between the publicly owned electric utility and the host local government, which Moody’s explains as follows:

A key consideration in Factor 2 is the relationship of the local government to the electric utility ... **Moody’s believes an established GFT [General Fund Transfer] transfer policy that is accepted by both the utility and the local government adds credit strength for both entities as it increases the predictability of the transfer amount ...** (*Id.* at 9-10, emphasis added)

Further, after the Third District Court of Appeal’s opinion was released in this case, Fitch Ratings Service warned of credit rating sensitivity that would arise as a consequence of these legal actions:

Electric system transfers account for a significant amount of general fund inflows in a number of other California cities including Glendale, Lodi, Los Angeles, Pasadena and Riverside. Fitch believes a trend of similar legal actions could

² Moody’s Investor Service, *Rating Methodology: U.S. Public Power Electric Utilities with Generation Ownership Exposure* (Nov. 9, 2011).

become a rating sensitivity in the coming years for those cities.³

The publications and opinions rendered by rating agencies such as Moody's and Fitch Ratings Service affect the cost of borrowing for public agencies. Therefore, substantial disruptions to established general fund transfer policies have the potential to interfere with the relationship between a local government and its electric utility, which could negatively impact both entities' credit ratings and finances. Such an event puts upward pressure on the electric utility and host city to increase rates for electrical services in order to cover increased costs of bond issuance and other financing expenses.

It is also relevant to note that when courts have analyzed the treatment of state taxes for investor owned utilities, these same general types of charges are clearly considered a "cost of service," which may be passed through to ratepayers via power rates:

Rates of a publicly regulated utility are based on two components: (1) the utility's operating expenses (cost of service), and (2) a fair return on its investment, which is found by multiplying its authorized rate of return by the value

³ Fitch Ratings Wire, *Ruling May Endanger Key Revenue Source for Some CA Cities* (Feb. 11, 2015), available at <https://www.fitchratings.com/gws/en/fitchwire/fitchwirearticle/Ruling-May-Endanger?pr_id=979527>[last viewed Aug. 18, 2015].

of property devoted to public use (rate base). (See *City and County of San Francisco v. Public Utilities Com.* (1971) 6 Cal.3d 119, 129, 98 Cal.Rptr. 286, 490 P.2d 798 (hereafter *City of San Francisco*.) **As taxes are part of a utility's cost of service, this expense is borne by the ratepayers.**⁴

It is clear that PILOTs and other similar transfers to city general funds are an integral part of the electric industry. Restrictions on this ability could have wide-ranging impacts on city finances. If existing PILOTs were eliminated or severely restricted, it could have the paradoxical impact of requiring municipal governments to either find alternative sources of revenue, accept a lower standard of municipal services, or even abandon the municipal utility model. This option would create further economic dislocation since municipal utilities provide power at lower rates than investor-owned utilities.⁵

II. THE PILOT TRANSFER FROM REDDING'S ELECTRIC UTILITY TO THE CITY'S GENERAL FUND IS NOT A TAX BECAUSE THE PILOT PREDATES PROPOSITION 26

There can be little argument that Proposition 26 is not retroactive with respect to local agencies and municipalities. "It is a widely recognized

⁴ *S. Cal. Gas Co. v. Pub. Utilities Com.* (1979) 23 Cal. 3d 470, 474 (emphasis added).

⁵ See, e.g., IV AR, Tab 166, pp. 1074, 1080-1085 (portion of the record showing Redding's rate in comparison to PG&E's rates).

legal principle, specifically embodied in section 3 of the Civil Code, that in the absence of a clear legislative intent to the contrary statutory enactments apply prospectively.” *Evangelatos v. Superior Court* (1988) 44 Cal.3d 1188, 1193-1194. A plain reading of Proposition 26 evidences that the sole retroactive application was to the State. (*See Brooktrails Township Community Services Dist. v. Board of Supervisors of Mendocino County* (2013) 218 Cal.App.4th 195, 205-06 [addressing Proposition 26 application].)

There is also no question that the formula for adjusting the amount of the PILOT to be paid in any given year was last modified by Redding in 2005, approximately 5 years prior to the passage of Proposition 26. The question then becomes, what specific *act or conduct* on the part of Redding occurred such that any protection it obtained due to the prospective nature of Proposition 26 somehow transmuted the otherwise valid PILOT charge into an unlawful tax?

Citizens point to two actions by Redding that they allege increased or extended the PILOT for purposes of triggering a review under Proposition 26: (a) Redding’s increase of its electrical rates in December 2010; and/or (b) the adoption of Redding’s budget in 2011. However, as discussed in detail below, these legislative acts neither extended nor increased the PILOT.

Citizens provide no authority by which Redding's increase of its electrical rates in 2010 or its adoption of its budget in 2011 would convert the PILOT post-Proposition 26 into a tax. Under *AB Cellular LA, LLC v. City of Los Angeles* (2007) 150 Cal.App.4th 747, 755, a tax increase occurs under California Constitution Article XIII C if the methodology by which a tax is calculated is revised. As long as a methodology is "frozen in time," there is no tax increase. (*See id.* at 761-62). Since the underlying methodology for the PILOT has not been changed since 2005, the PILOT has not been increased under this standard.

Similarly, there was no "extension" of Redding's PILOT. Citizens have not alleged that there was a sunset provision of the PILOT for which it *could* be extended by any action of Redding, nor could it, as the PILOT itself has been in effect since 1988. As made clear by the record, the express intent of the Redding City Council was to maintain the PILOT in its current form – there was no act made on behalf of Redding to extend it.

In an attempt to resolve their statutory dilemma, Citizens rely on a very narrow exception to the general rule espoused in Government Code section 9605. The general rule states:

Where a section or part of a statute is amended, it is not to be considered as having been repealed and reenacted in the amended form. The portions which are not altered are to be considered as having been the law from the time when they were enacted; the new provisions are to be considered as

having been enacted at the time of the amendment; and the omitted portions are to be considered as having been repealed at the time of the amendment.⁶

Citizens cite to *Barratt American, Inc. v. City of Rancho Cucamonga* (2005) 37 Cal.4th 685 for the proposition that, despite the plain language of Government Code section 9605 and Redding's resolution, the PILOT was renewed after November 2010. In so doing, Citizens fail to note that *Barratt* dealt solely with a very specific provision of the Mitigation Fee Act (Gov. Code § 66000, *et seq.*), which concerns development and permit fees in accordance with its own statutory framework. Citizens also failed to note the single finding by the court in *Barratt* that allowed it to apply the reenactment rule to its specific set of facts: it found the resolution adopted by the City of Rancho Cucamonga modified or amended (as those terms are defined within the Mitigation Fee Act) its entire fee structure because the City's resolution "...changed the *duration* of the fee by extending its applicability." [Emphasis in original] (*Id.* at 728). Redding did not increase or extend the PILOT per Government Code section 53750.

⁶ Whether the inquiry goes to a city's legislative act as opposed to state statutes is of no consequence with respect to the interpretation of the underlying language. (*See, e.g., City of San Diego v. Shapiro* (2014) 228 Cal.App.4th 756, 789 ["Generally, the same principles of construction applicable to statutes apply to the interpretation of municipal charters."]).

The 'reenactment' principle has never been applied in the context of budget adoptions, and this Court should decline to extend that narrow principle here.

III. THE PILOT TRANSFER FROM REDDING'S ELECTRIC UTILITY TO THE CITY GENERAL FUND REFLECTS REASONABLE COSTS OF SERVICE

Even if Proposition 26 applies to the pre-existing PILOT, the PILOT reflects the utility's reasonable costs of service and is therefore not a tax. Like other municipal general fund transfers throughout California, the City's PILOT recovers costs for street maintenance, fire and police protection, administration, and other important benefits the City provides to the electric utility.

Importantly, the City's PILOT is intended to approximate taxes a private utility such as Pacific Gas & Electric would pay to the City if it served its residents.⁷ A city operating a utility incurs the same costs to support operation of an electric utility as one served by an investor-owned utility and therefore a general fund transfer mechanism such as a PILOT avoids foregoing revenue required to support those services. The City's long standing PILOT is fixed at 1% of the value of the utility's assets and mirrors the rate private utilities pay other cities where they operate.

PILOTs are common and integral to the public power utility model (*see*

⁷ *Citizens for Fair REU Rates v. City of Redding* (2015) 182 Cal.Rptr.3d 722, 738 (dis. opn. of Duarte, J.)).

Section I above), providing revenue certainty needed by municipalities to recoup service costs and ensure sound business operations.

Justice Duarte in her dissent to the Third District Court of Appeal's opinion in this case acknowledged the many factors that make up a utility rate structure, finding that the PILOT is reasonable as a matter of law because it equaled what a private utility would pay in property taxes to the City. (*Citizens, supra*, 182 Cal.Rptr.3d at 738 (dis. opn. of Duarte, J.)). This court should do the same by recognizing that the universal application of property taxes on private utilities justifies the reasonableness of the PILOT as a cost of service. As Justice Duarte noted, the PILOT "does not result in an unreasonable charge for providing electric service" because the PILOT is consistent with Proposition 13 and implementing legislation. (*Id.*) Accordingly, application of the PILOT is "fair" and "reasonable" under Proposition 13 and Proposition 26.

An overly restrictive interpretation of "reasonable cost" would threaten the public power model. Citizens' attempt to apply the more stringent Proposition 218 "proportional" cost of service principles to this case would invalidate lawful charges under Proposition 26. Proposition 26 is not as exacting as Proposition 218, requiring, instead, a "fair or reasonable" allocation of costs among ratepayers (Cal. Const., art. XIII C, § 1 subd. (e)(2) & final, unnumbered para.). Conflating Proposition 218 and Proposition 26 would set a dangerous precedent for the public power

utility industry in California. Even though some electric utilities also provide water service, electric service and water service are separate and distinct, each with their own costs and revenue requirements and — most importantly — rate structures. Electric and gas service fees are not subject to Proposition 218's standard (Cal. Const., art. XIII D, § 3, subd. (b)), and to hold otherwise would jeopardize PILOTs and have wide-ranging impacts on the electric utility industry.

CONCLUSION

For all these reasons, CMUA respectfully requests that the Court reject the arguments raised by the Appellants and affirm the trial court's findings on the issues presented for review.

Dated: August 18, 2015

Respectfully submitted,

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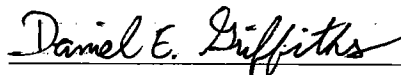
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CERTIFICATE OF WORD COUNT

The text of APPLICATION BY THE CALIFORNIA MUNICIPAL UTILITIES ASSOCIATION TO FILE A BRIEF AS AMICUS CURIAE AND PROPOSED BRIEF IN SUPPORT OF PLAINTIFFS AND RESPONDENTS, THE CITY OF REDDING consists of 2,803 words (including footnotes but excluding the table of contents, the table of authorities, and certificates) as counted by Microsoft Word 2011 word-processing program.

Dated August 18, 2015



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CERTIFICATE OF SERVICE

I hereby certify that I am a citizen of the United States, over the age of 18 years, with business address at 915 L Street, Suite No. 1270, Sacramento, California and am neither a party nor interested in the within action.

On August 18, 2015, in Sacramento, California, I caused to be served the following:

APPLICATION BY THE CALIFORNIA MUNICIPAL UTILITIES ASSOCIATION TO FILE A BRIEF AS AMICUS CURIAE AND PROPOSED BRIEF IN SUPPORT OF DEFENDANTS AND RESPONDENTS, THE CITY OF REDDING, ET AL.

X OVERNIGHT MAIL: I caused such true copy of the above document to be delivered to UPS for overnight courier service to the office of the party as set forth below:

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X I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Dated August 18, 2015



Paula Palomo

SERVICE LIST

Citizens for Fair REU Rates v. City of Redding

Third District Court of Appeal Case No. C071906

California Supreme Court Case No. S224779

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