

City's Transfer of Revenue from Municipal Electric Utility to General Fund to Recover Costs of City Services Upheld

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A city's practice of transferring revenue from its municipal electric utility's enterprise fund to its general fund has been upheld by the California Supreme Court.

In *Citizens for Fair REU Rates v. City of Redding*, the Supreme Court considered the constitutionality of a "payment in lieu of taxes" or PILOT paid from the city's electric utility to the city's general fund. Redding's PILOT represented the amount of revenue a private utility would otherwise pay the city in property taxes for the purpose of recovering the cost of services provided by other city departments to the electric utility. In fiscal year 2010-2011, for example, Redding transferred \$6 million to its general fund under the PILOT.

Plaintiffs claimed that the PILOT inflated electric utility rates above the cost of providing electric service to customers. This produced surplus electric utility revenues for the city to transfer to its general fund. Therefore, the Court should invalidate the electric utility rates as illegal taxes that had not been approved by the voters, as required by Proposition 26.

The Supreme Court rejected this argument. According to the Court, the critical question under Proposition 26 is whether the rates exceed the reasonable cost of providing electricity. Based on its financial records, Redding had actually charged ratepayers less than the projected cost of providing electricity to its customers. Non-ratepayer revenues the utility received, such as wholesale electricity sales, closed the gap between rate revenue and the utility's projected expenses. Importantly, revenue from sources other than rate-payers covered the expense of the PILOT. Therefore, the Supreme Court held that the electric utility rates were not illegal taxes. Furthermore, the utility was not required to use the revenue from sources other than rate-payers to lower its customers' rates.

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The Supreme Court did not address whether the PILOT could be a reasonable cost of providing electric service because Redding's rate revenue was less than all of the other operating costs that plaintiffs agreed were part of providing electric service. A local agency that provides electric service should consult with legal counsel before transferring enterprise funds to its general fund.

For more information on the case or any tax or fee matter, please contact **Nick Ghirelli, Trisha Ortiz**, or any of the members of the Firm's **Public Finance Department**.