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September 26, 2011

REPORT TO THE HONORABLE
MAYOR AND CITY COUNCIL

PROPOSITION 26'S APPLICATION TO THE PROPOSED AMENDMENTS TO THE
TOURISM MARKETING DISTRICT PROCEDURAL ORDINANCE

INTRODUCTION

On August 1, 2011, the first reading of an ordinance concerning proposed amendments to the Tourism Marketing District Procedural Ordinance (TMD Procedural Ordinance) was on the docket for consideration by the San Diego City Council. On July 29, 2011, the Office of the City Attorney issued Report to Council RC-2011-30, titled Proposed Amendments to the San Diego Tourism Marketing District Procedural Ordinance. The City Council approved the first reading of the TMD Procedural Ordinance. The second reading of the TMD Procedural Ordinance was docketed for September 13, 2011. On the evening of September 12, 2011, attorney Andrew Kahn sent a letter to the City Council raising certain arguments regarding the applicability of Proposition 26 (Prop 26) to the TMD Procedural Ordinance. At the September 13, 2011 City Council meeting, the City Attorney requested a two-week continuance in order to review and address these arguments. This Report expands upon the analysis provided in Report to Council RC-2011-30 and addresses the arguments raised by Mr. Kahn.

QUESTIONS PRESENTED

1. Is the current Tourism Marketing District subject to challenge under Proposition 26?
2. Is the proposed action of the City Council to adopt the amendments to the TMD Procedural Ordinance vulnerable to challenge under Proposition 26?
3. Is a future Tourism Marketing District vulnerable to challenge under Proposition 26?

SHORT ANSWERS

1. No. The provisions of Proposition 26 are not retroactive as applied to local governments.
2. Not likely. A strong argument can be made that the amended TMD Procedural Ordinance is defensible against a constitutional challenge.
3. There is a great deal of uncertainty surrounding Proposition 26, particularly with respect to its application to business-based assessments such as those levied by a Tourism Marketing District. This uncertainty necessarily carries with it a degree of risk and the defensibility of a Tourism Marketing District will ultimately rest on the strength of the formational documents, such as the District Management Plan.

ANALYSIS

I. THE FORMATION OF THE SAN DIEGO TOURISM MARKETING DISTRICT AND THE COLLECTION OF ASSESSMENTS ARE MODELED ON THE PBID LAW.

The Tourism Marketing District (TMD) was conceived and developed by representatives from the hotel industry in partnership with the City as a result of diminishing public resources available for effective and competitive destination marketing. Industry representatives were interested in developing a new source of revenue for marketing and promotion of the lodging industry business in San Diego.

In California, tourism assessment districts, such as the TMD, are formed pursuant to the Property and Business Improvement District Law of 1994 (PBID Law), the Parking and Business Improvement District Law of 1989 (BID Law), or by an enabling ordinance of a charter city. In San Diego, the City chose to utilize the third method and adopted an enabling TMD Procedural Ordinance, which is modeled on the 1994 PBID Law. On May 8, 2007 the City Council adopted the San Diego TMD Procedural Ordinance, San Diego Municipal Code sections 61.2501 to 61.2527, which allowed for the creation of a TMD.

In late-2007, pursuant to the TMD Procedural Ordinance, hotel industry representatives collected petitions in favor of the formation of the TMD. The City initiated proceedings to form the TMD upon the submission of the written petitions, signed by the hotel owners in the TMD who would pay more than 50 percent of the TMD assessments. The petitions were accompanied by a summary of the District Management Plan for the proposed operations of the district. The District Management Plan is the foundational legal document of the TMD and includes, among other things, a description of the boundaries of the district, a general description of the activities to be funded, sources of financing, the length of time the assessments will be levied, and rules and regulations for the TMD.

Having received sufficient petitions submitted in support of the TMD, the City Council adopted a Resolution of Intention to establish the current TMD, caused a ballot to be mailed to all affected businesses, and gave notice of the required public hearing. Part of the public hearing

process includes a tabulation of the ballots to determine if a majority protest exists against the formation of the TMD. If a majority protest existed, the current TMD would not have been formed. The City did not receive a majority protest, therefore, the City Council established the current TMD by San Diego Resolution R-303226 with an effective date of January 1, 2008. The current TMD's five-year term is set to expire on December 31, 2012.¹

The City of San Diego oversees the collection of the assessments and ensures that the expenditure of funds is consistent with the District Management Plan and TMD Procedural Ordinance. Pursuant to the TMD Procedural Ordinance, the City also contracted with the San Diego Tourism Marketing District Corporation (TMD Corporation), a nonprofit corporation, to implement the District Management Plan and carry out specified activities, subject to the terms and conditions enumerated in the contract with the TMD Corporation. The TMD Corporation, as part of its administration of the TMD, brings forward an annual report to the City Council that, among other things, indicates the incremental room nights and return on investment (ROI) generated by each of the TMD's funding categories. According to the TMD Corporation, the ROI is calculated on the revenue associated with the incremental hotel room nights generated exclusively for TMD-assessed hotels.

As stated above, the current TMD's five-year term is set to expire on December 31, 2012. As such, the City and hotel industry representatives have been preparing to re-form a TMD in the City. As part of this preparation, there was a desire to update and amend the TMD Procedural Ordinance. Many of the proposed amendments were made with the specific goal of requiring that any future TMD be formed and operated in compliance with all applicable local and State laws in effect since 2007 and to allow for a TMD term of up to forty years.

II. PROPOSITION 26 DEFINES THE TERM "TAX."

On November 2, 2010, California voters approved Prop 26, a ballot initiative that amends provisions of articles XIII A and XIII C of the California Constitution by limiting the ability of local government agencies to impose fees and charges. As a result, "any levy, charge, or exaction of any kind" imposed by local government agencies on or after November 3, 2010 is considered a special tax requiring two-thirds voter approval unless the charge is for:

1. A benefit or privilege conveyed directly to the payor that is not provided to those not charged;
2. A service or a product provided directly to the payor that is not provided to those not charged;
3. Certain regulatory fees;
4. Entrance fees, or charges for the purchase, rental, or lease of local government property;

¹ An extension of the current TMD is the equivalent of forming a new TMD because the renewal would necessarily require the City Council's authorization of further assessments. Therefore, even renewing the current TMD under the current TMD Procedural Ordinance would require the same Prop 26 analysis as the City is faced with here, except that a renewal under the current TMD Procedural Ordinance could only be effectuated for another 10 years before having to renew again.

5. Fines imposed by the judicial branch or local government for a violation of law;
6. A charge imposed as a condition of property development; or
7. Assessments and property-related fees imposed in accordance with article XIII D of the California Constitution.

Previously, the California Constitution did not define the term “tax,” but relied on court decisions to distinguish taxes from other government revenue measures such as assessments, fees, and fines.

III. THE CURRENT TOURISM MARKETING DISTRICT IS NOT SUBJECT TO CHALLENGE UNDER PROPOSITION 26 BECAUSE THE PROVISIONS OF PROPOSITION 26 ARE NOT RETROACTIVE AS APPLIED TO LOCAL GOVERNMENTS.

Mr. Kahn’s letter asserts that allocations of the current TMD, such as the fixed allocations to the San Diego Convention and Visitors Bureau and the San Diego North Convention Center and Visitors Bureau, as well as the variable funding allocations to other contractors would violate Prop 26. However, the provisions of Prop 26 do not apply to the current TMD.

A statute will not be applied retroactively unless there is an express retroactivity provision or it is abundantly clear from extrinsic sources that the legislature or the voters must have intended the statute to be applied retroactively. *Evangelatos v. Superior Court*, 44 Cal. 3d 1188, 1209 (1988). Prop 26 expressly applies retroactively to State measures adopted between January 1, 2010 and Prop 26 effective date, but does not contain any such retroactivity provision with respect to local governments. Therefore, we must presume that the retroactivity provision was specifically excluded as it relates to local governments. To do otherwise, would violate the canon of statutory construction, *expressio unius est exclusio alterius* (“to say one thing is to exclude another”). “This maxim ‘expresses the learning of common experience that when people say one thing they do not mean something else.’” *Arden Carmichael, Inc. v. County of Sacramento*, 93 Cal. App. 4th 507, 516 (2001) (citing 2A Singer, Sutherland Statutes and Statutory Construction, *Intrinsic Aids*, § 47.24, at 319-20 (6th ed. 2000)).

The specific inclusion of retroactivity language for certain State measures and conspicuous exclusion regarding local measures in Prop 26 supports the presumption against retroactive application of the provisions of Prop 26 as it relates to local governments. “While every word of a statute must be presumed to have been used for a purpose, it is also the case that every word excluded from a statute must be presumed to have been excluded for a purpose.” *Arden Carmichael*, 93 Cal. App. 4th at 516 (citing 2A Singer, Sutherland Statutes and Statutory Construction, *Literal Interpretation*, § 46.06, at 192 (6th ed. 2000)). This presumption against retroactivity was supported by the Legislative Analyst in its analysis of Prop 26, which stated that existing fees and charges are not affected by Prop 26 unless they are later increased or extended. Official Voter Information Guide, California General Election, Tuesday, November 2, 2010, Proposition 26, Analysis by the Legislative Analyst at 58. In this instance, the City is not increasing or extending the assessments of the current TMD. The City is merely proposing the

adoption of amendments to the TMD Procedural Ordinance which, among other things, sets the rules by which a new TMD can be formed.

IV. THE CITY COUNCIL'S PROPOSED ACTION TO ADOPT THE AMENDMENTS TO THE TMD PROCEDURAL ORDINANCE IS DEFENSIBLE TO A CHALLENGE UNDER PROPOSITION 26.

An argument has been made that Prop 26 requires that the TMD Procedural Ordinance be approved by a two-thirds majority public vote. As discussed in Section I above, Prop 26 adds a definition of "tax" to the California Constitution: "(e) As used in this article, 'tax' means any levy, charge, or exaction of any kind imposed by a local government . . ." excluding those that meet one of the seven enumerated exceptions. Cal. Const. art. XIII C, § 1(e). The proposed action before the City Council on September 27 is not intended to impose a levy, charge, or exaction of any kind. The proposed action merely adopts amendments to the TMD Procedural Ordinance which sets the rules by which a new TMD can be formed. The proposed action does not form a TMD, authorize a budget for a TMD, approve a District Management Plan for a TMD, or authorize the levy of any assessments. Therefore, if the City Council adopts the proposed amendments to the TMD Procedural Ordinance, and that adoption is challenged, the challenge would have to be a challenge to the constitutionality of the amended TMD Procedural Ordinance.

A constitutional challenge to an ordinance may be facial or as-applied. *Sturgeon v. Bratton*, 174 Cal. App. 4th 1407, 1418 (2009). An as-applied challenge depends on the existence of previous or current instances of unconstitutional applications. *Id.* at 1418-19. Because the proposed amended TMD Procedural Ordinance has not yet been applied, it is not vulnerable to an as-applied challenge. If an opponent desires to challenge the amended TMD Procedural Ordinance as an unconstitutional violation of Prop 26, the opponent would likely assert a facial challenge.

A facial challenge to the constitutional validity of a statute or ordinance considers only the text of the measure itself. The challengers must demonstrate that the ordinance's provisions inevitably pose a present, total, and fatal conflict with applicable constitutional prohibitions. *Id.* at 1418. Here, the proposed amendments to the TMD Procedural Ordinance specifically include requirements that any future TMD be formed in compliance with the provisions of Prop 26. Specifically, the amended TMD Procedural Ordinance requires that any TMD formed must convey a specific benefit directly to the payors that is not provided to those not charged. To support a determination of facial unconstitutionality, those challenging the ordinance cannot prevail by suggesting that in some future hypothetical situation constitutional problems may arise as to the particular application of the ordinance. *Id.* Mr. Kahn's letter argues that a future, hypothetical TMD will operate in a particular manner with particular funding allocations. Under *Sturgeon* that assumption would not support a facial challenge to the proposed amended TMD Procedural Ordinance. Accordingly, the City would prevail in a facial challenge that the TMD Procedural Ordinance is unconstitutional.

V. FORMATION OF A TOURISM MARKETING DISTRICT UNDER THE PROPOSED AMENDED TOURISM MARKETING DISTRICT PROCEDURAL ORDINANCE SHOULD ENSURE A SPECIFIC BENEFIT IS CONFERRED TO THE ASSESSED BUSINESSES THAT IS NOT PROVIDED TO THOSE NOT CHARGED.

We do not have the benefit of case law to help guide us with respect to the court's application of Prop 26 to tourism assessment districts such as the TMD.² There is a great amount of uncertainty surrounding Prop 26 and its application to these business-based assessment districts. This uncertainty necessarily means there is risk to the City in forming a new TMD without first seeking voter approval. In order to alleviate some of the risk, many of the proposed amendments clarify that the TMD Procedural Ordinance shall be used to form a TMD which provides a specific and direct benefit to the assessed businesses that is not provided to those not assessed in accordance with the first exception to Prop 26.

Proponents of the TMD assert that a TMD assessment could fall within the seventh exception to Prop 26. This exception excludes from the new definition of tax: "[a]ssessments and property-related fees imposed in accordance with the provisions of Article XIII D." Cal. Const. art. XIII C, §1(e)(7) (emphasis added). However, further legal review and analysis strongly suggests that the voters intended for this exception to only apply to assessments on real property as opposed to business related assessments. See Cal. Gov't Code § 53750.

However, assuming the assessment confers a specific benefit directly to the assessed businesses that is not provided to those not assessed, a strong argument can be made that the assessment would fall within the first exception to Prop 26. The first exception to Prop 26 is found in article XIII C, section 1(e)(1) of the California Constitution, which excludes from the new definition of tax "[a] charge imposed for a specific benefit conferred or privilege granted directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of conferring the benefit or granting the privilege." There are differing opinions with regards to whether the first exception to Prop 26 is applicable to business-based assessments, such as the TMD. A number of experts in the special assessment district industry believe that this exception applies to business-based assessments. However, the Legislative Analyst's impartial analysis of Prop 26 identifies non-property-based assessments as being potentially converted to taxes requiring voter approval pursuant to Prop 26: "[S]ome business assessments could be considered to be taxes because government uses the assessment revenues to improve shopping districts (such as providing parking, street lighting, increased security, and marketing), rather than providing a direct and distinct service to the business owner." Official Voter Information Guide, California General Election, Tuesday, November 2, 2010, Proposition 26, Analysis by the Legislative Analyst at 58.

With the lack of case law on the subject, there is much uncertainty surrounding the application of Prop 26 to tourism assessment districts. This uncertainty means there are risks associated with the City's formation of a new TMD. The proposed amendments to the TMD Procedural Ordinance were drafted to reduce these risks by including language that compels

² There have been at least 7 tourism assessment districts such as the TMD that have either been formed, increased, or expanded in California since the passage of Prop 26 and, to date, none have been challenged.

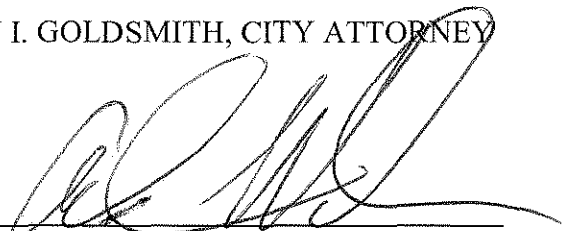
conformance to the requirements of Prop 26. Accordingly, careful attention must be made during the formation of a TMD to ensure that it complies with the proposed amended TMD Procedural Ordinance and that every facet of the TMD is designed to confer a specific benefit directly to the assessed businesses that is not provided to those not assessed.

CONCLUSION

The current TMD is not vulnerable to challenge under Prop 26 because the provisions of Prop 26 will not be applied retroactively with respect to local governments. The proposed action before City Council to adopt the amendments to the TMD Procedural Ordinance is defensible against challenge that it violates Prop 26 because the amended TMD Procedural Ordinance is not ripe for an as-applied challenge and has been drafted so that it would likely survive a facial challenge. However, a future TMD formed under the TMD Procedural Ordinance still poses some risks to the City. The majority of the risk comes from the uncertainty surrounding the application of the newly-enacted Prop 26 to districts such as a TMD. Careful attention must be made in the formation of a TMD to ensure that every facet of the TMD is designed to confer a specific benefit directly to the assessed businesses and that such benefit is not provided to those not assessed. The defensibility of a TMD will ultimately rest upon the strength of the supporting record, particularly the District Management Plan. During the formation or renewal of a TMD, when the City and business owner representatives are determining which services will be provided using TMD funds, the necessity of these services conferring a specific and direct benefit to only the payors must be kept at the forefront of the decision-making process. As they come forward, this Office can assist in the evaluation of the proposed activities of any future TMD.

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RC-2011-36