

May 31, 1996

REPORT TO THE COMMITTEE ON NATURAL
RESOURCES AND CULTURE

THE LEGALITY OF LEGISLATIVE AND ECONOMIC FLOW CONTROL

In a memorandum dated May 22, 1996, Marc Kuritz, Committee Consultant for the Natural Resources and Culture Committee, asked whether a franchise fee imposed by The City of San Diego would constitute illegal legislative or economic flow control. Our office has researched and concluded that the franchise fee would not constitute illegal legislative or economic flow control. In addition, our office has analyzed whether the City could include a flow control provision within the proposed nonexclusive franchise ordinance and has concluded that a flow control provision may violate the Commerce Clause. (U.S. Const. art. I, sec. 8, cl. 3). The Commerce Clause grants to Congress the power to regulate Commerce among the States. The following is our analysis.

Legislative Flow Control

Legislative flow control is when a public agency enacts an ordinance requiring the waste stream to be deposited at a certain disposal site. In *C & A Carbone, Inc. v. Town of Clarkstown, N.Y.*, 114 S.Ct. 1677, 1682-1683 (1994), the U.S. Supreme Court held that a flow control ordinance enacted by the town of Clarkstown violated the Commerce Clause. In essence, Carbone eliminated legislative flow

control. It precludes the City from legislatively controlling the flow of waste.

Economic Flow Control

Economic flow control is where a public agency controls the flow of waste pursuant to a tipping fee charged at a disposal site. A hauler of solid waste will deliver the waste to a facility because the cost of disposal at the facility is less than or comparable to alternative disposal sites. An example of economic flow control is illustrated in *Swin Resource Systems, Inc. v. Lycoming County*, 883 F.2d 245, 250 (3d Cir. 1989) where the Court held that a local government operating a landfill may lower a tipping fee for the disposal of locally generated waste because it was a "market participant." (See analysis below regarding "market participant" exception.) Consequently, the City may lower its tipping fee at Miramar Landfill to generate a waste flow sufficient to meet its statutory and regulatory requirements.

Franchise Fee

The franchise fee is a separate issue from the flow control issue. The legal standard of a franchise fee is that it must be reasonable. The proposal of a franchise fee based on approximately 10% of gross receipts, as mentioned in the City Manager's Report No. 96-117, is not per se unreasonable.

Flow Control Provision - Nonexclusive Franchise

A flow control provision in a franchise ordinance would require a franchisee to dispose of waste at a facility owned by the City. In addition, it would include a penalty provision if the franchisee failed to comply with the flow control provision. The issue is whether the City could include such a flow control provision in the proposed nonexclusive franchise ordinance.

A recent federal court case sheds light on whether such a flow control provision in the draft nonexclusive franchise ordinance would withstand legal challenge. In *SSC Corp. v. Town of Smithtown*, 66 F.3d 502, 518 (2nd Cir. 1995), the court held that

1. Smithtown's flow control ordinance, which is enforceable through criminal penalties, constitutes market regulation rather than market participation. The ordinance is indistinguishable from the one struck down by the Supreme Court in *Carbone* and thus violates the dormant Commerce Clause.

2. The improvement contract constitutes municipal participation in both the waste collection

and disposal markets, and thus does not violate the Commerce Clause.

In *SSC Corp.*, Smithtown, a municipality, began negotiations with a neighboring town of Huntington to provide joint waste disposal service for the residents of both towns. *Id.* at 506. The towns entered into a municipal agreement to share Smithtown's existing landfill and Huntington's incinerator. *Id.* The construction of the incinerator was financed by the issuance of tax-free bonds. *Id.* at 507. The bonding authority lent the proceeds from the bonds to the private operator of the incinerator to construct the incinerator. *Id.* These bonds were secured by contract between the private operator and Smithtown and Huntington. *Id.* A service fee was paid to the private operator of the incinerator regardless whether any waste was delivered to the incinerator. *Id.* The service fee was paid by revenues generated from an ad valorem property tax and tipping fees at the incinerator. *Id.*

To ensure a steady flow of tipping fees, Smithtown passed a flow control ordinance which required SSC Corporation, a private hauler, to transport all residential and commercial waste collected within the city limits to the incinerator located in Huntington. *Id.* Smithtown also entered into a contract with SSC Corporation to collect, transport, and dispose of Smithtown's solid waste. *Id.* The disposal of the solid waste was at Huntington's incinerator. *Id.*

As indicated, the flow control ordinance was overturned because it violated the Commerce Clause. *Id.* at 512-514. By enacting the ordinance, Smithtown was considered a "market regulator" versus a "market participant" because it utilized criminal penalties to completely control the flow of waste. *Id.* at 512-513. Since Smithtown

failed to qualify as a "market participant," which would have taken it outside the application of the Commerce Clause, the ordinance was overturned as an attempt to legislatively control the flow of waste. Id. at 513.

However, the contract between Smithtown and SSC Corporation requiring successful bidders to utilize the incinerator withstood legal challenge. Id. at 514-517. As to collection and disposal of waste which it had a public obligation to collect, the court found the town to be a "market participant" which is an exception to the Commerce Clause. Id. at 510. The court indicated that "when a state engages in market 'participation'- that is, when it enters the open market as a buyer or seller on the same footing as private parties-there is less danger that the state's activity will interfere with Congress's plenary power to regulate the market". Id. (See U.S.A. Recycling, Inc. v. Town of Babylon, 66 F.3d 1272, 1282-1283 (2nd Cir. 1995).)

Smithtown contracted with SSC Corporation and was receiving solid waste collection and disposal services that it could have done itself with City trucks and employees. Id. at 515. It was expending city

funds for this service. Thus, through the "market participant" exception, Smithtown was able to direct the flow of waste. Id. In other words, Smithtown was permitted to enter a market with the same freedoms and restrictions as a private party. Id. at 510.

In comparison, The City of San Diego, it appears, would be unable to meet the "market participant" exception discussed in SSC Corp. The City does not have the legal authority to collect commercial waste with one exception. (See San Diego Municipal Code section 66.0123(c)(ii).) Generally, since the City lacks the authority to collect, transport, and dispose of commercial waste it would be difficult to be a "market participant." The City does not expend any City funds for the collection, transportation, and disposal of commercial waste. With no expenditures of City funds coupled with the lack of authority to comprehensively collect commercial waste, the draft flow control provision of the nonexclusive franchise may violate the Commerce Clause.

Conclusion

1. Legislative flow control is unlawful.
2. Economic flow control is a viable alternative to control the

flow of waste.

3. A franchise fee must be reasonable.

4. Absent a finding that the City is a "market participant", a flow control provision within the proposed nonexclusive franchise ordinance may violate the Commerce Clause.

Respectfully submitted,

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