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MEMORANDUM OF LAW

DATE: March 4, 2011

TO: Honorable Mayor and City Council

FROM: City Attorney

SUBJECT: Proposition 26 And Its Impact On City Fees And Charges

INTRODUCTION

On November 2, 2010, California voters approved Proposition 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, increased, or extended by local government agencies on or after November 3, 2010,¹ is considered a special tax requiring two-thirds’ voter approval unless the fee is for:

- A benefit or privilege conveyed
- A service or a product
- Certain costs of regulation
- Entrance fees and fees for use of state or local property
- Fines imposed by a court or a local government
- Development impact fees imposed by a local government
- Assessments and property-related fees governed by Proposition 218

Like Proposition 218, we believe Proposition 26 intends the description “levy, charge, or exaction of any kind” to include all revenue sources available to local government agencies. *Bighorn-Desert View Water Agency v. Verjil*, 39 Cal. 4th 205 (2006). Thus, Proposition 26 is triggered whenever a local government agency (local agency) imposes a fee, a charge, a levy, or any other revenue source².

¹ Proposition 26 does not have retroactive effect. *Strauss v. Horton*, 46 Cal.4th 364 (2009).

² This Memorandum of Law uses the term “fee” to describe all source of revenue available to a local agency as it relates to Proposition 26 including, but not limited to, charges, levies, exactions, and assessments.

Although not defined by Proposition 26 or in prior legislation, the term “impose” implies an exertion of force by government action, as when a local agency levies a tax. *See*, Black’s Law Dictionary (9th ed. 2009), which defines “impose” as “[t]o levy or exact (a tax or duty).” Accordingly, we do not believe a fee is “imposed” if a private party voluntarily agrees to pay a fee, as one would do when negotiating the terms of a contract, or where a taxpayer elects to pay a fee to local agency for a service the taxpayer could obtain from a private party. If, however, a local agency is the sole provider of the service or product; provides a service or product because it is required by law to do so; or the service is commonly provided by local government agencies, a court will likely determine the local agency has imposed a charge.

We also do not believe the term “impose” affects the continued collection of an existing revenue measure. *See, McBrearty v. City of Brawley*, 59 Cal. App. 4th 1441 (1997), which held the continued collection of tax is not an “imposition” of tax requiring voter approval under Proposition 62³.

The terms “increase” and “extend” were defined in Article XIII C of the California Constitution and implementing legislation (Cal. Gov’t Code § 53750) prior to the approval of Proposition 26. A tax, fee, or charge is “increased” by an agency action when the agency either increases any applicable rate used to calculate the tax, assessment, fee or charge, or revises the methodology by which the tax, assessment, fee or charge is calculated, if that revision results in an increased amount being levied on any person or parcel⁴. Cal. Gov’t Code § 53750(h). A fee is “extended” when the agency prolongs an existing tax, fee, or charge, “including, but not limited to, amendment or removal of a sunset provision or expiration date.” Cal. Gov’t Code § 53750(e).

If challenged, a local agency has the burden of proving by a preponderance of the evidence that the charge is not a tax, that the amount is no more than necessary to cover the reasonable costs of the governmental activity, and that the manner in which those costs are allocated to a payor bear a fair or reasonable relationship to the payor’s burdens on, or benefits received from, the governmental activity.

Consistent with Administrative Regulation (AR) 95.25 and Council Policy 100-05 (User Fees), City departments bring requests for new and revised fees and charges to the City Council each spring. This Memorandum of Law is intended as a general guide in determining whether a proposed fee or charge may be imposed, extended, or increased under Proposition 26.

³ Disapproved by *Howard Jarvis Taxpayers Association v. City of La Habra* (2001) 25 Cal.4th 809, insofar as it held an action to invalidate a tax under Proposition 62 did not accrue until the filing of *Santa Clara County Local Transportation Authority* (1995) 11 Cal. App. 4th 220.

⁴ California Government Code section 53750(h), which is specific to Proposition 218, discusses additional examples of what an increase is not. Proposition 218 expanded restrictions on local government revenue-raising by adding Article XIII C and XIII D to the Constitution, which allows voters to repeal or reduce taxes, assessments, fees, and charges through the initiative process, reiterates voter approval is required for “special taxes” and “general taxes,” and imposes limitations on assessments of real property and other fees.

ANALYSIS

I. 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 AN EXCEPTION APPLIES

A. The user fee exception

This exemption relates to a charge⁵ 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. Such charges are commonly referred to as “user fees.”

1. For the exception to apply, the payor must benefit from his or her expenditure.

A user fee is not a tax and not subject to voter approval if it is “charged only to the person actually using the service” and “the amount of the charge is generally related to the actual goods or services provided.” *Isaac v. City of Los Angeles*, 66 Cal. App. 4th 586, 596-597 (1998). A user fee is “payment for a specific commodity purchased.” *Ibid*.

The concept of the payor as the beneficiary is discussed in *Weisblat v. City of San Diego*, 176 Cal. App. 4th 1022, 1038 (2009). “Special assessments and development, regulatory and user fees are generally not regarded as taxes, and thus are exempt from the reach of article 13A, because with each of these levies, a discrete group receives a benefit, service, or public improvement that inures to the benefit of that discrete group.”

A user fee is a special tax if it benefits the public as a whole instead of just the persons using the service; is not based on actual or anticipated use; or does not relate to a government service. *See*, for example, *Bay Area Cellular Telephone Co. v. City of Union City*, 162 Cal. App. 4th 686 (2008), which deemed a city-imposed fee on telephone lines within the city to fund 911 service a special tax and not a user fee because the fee inured to benefit of public as a whole instead of to any particular group; was not based on actual or estimated use of 911 service; was imposed upon obtaining service from a private provider rather than from government; and was not limited to new telephone customers.

A user fee does not become a tax requiring voter approval if the public as a whole is *incidentally* benefitted by the expenditure of the proceeds of these levies as long as a discrete

⁵ A “charge” is the price, cost, or expense that may include a delinquency charge, a finance charge, or a late charge. Black’s Law Dictionary (9th ed. 2010).

group is specially benefitted by the expenditure. *Id.*, referencing *Evans v. City of San Jose*, 3 Cal. App. 4th 728, 738 (1992); *Bay Area Cellular Telephone Co. v. City of Union City*, 162 Cal. App. 4th 686, 695 (2008).

2. For the exception to apply, the charge cannot exceed the reasonable cost incurred by the local agency in providing the benefit or privilege.

To be reasonable, a “user fee” must be fair and equitable in nature and proportionately representative of the costs incurred by the regulatory agency. It is proper and reasonable to take into account not only the expense of direct regulation, but all the incidental consequences that may be likely to subject the public to cost. *United Business Commission v. City of San Diego*, 91 Cal. App. 3d 156 (1979), referencing *County of Plumas v. Wheeler*, 149 Cal. 758 (1906). “The government should prove (1) the estimated costs of the service or regulatory activity, and (2) the basis for determining the manner in which the costs are apportioned, so that charges allocated to a payor bear a fair or reasonable relationship to the payor’s burdens on or benefits from the regulatory activity.” *Collier v. City and County of San Francisco*, 151 Cal. App. 4th 1326, 1346 (2007), citing *San Diego Gas and Electric Company v. San Diego County Air Pollution Control District*, 203 Cal. App. 3d 1132, 1146 (1988).

In *Beaumont Investors v. Beaumont-Cherry Valley Water District*, 165 Cal. App. 3d 227 (1985), for example, a water district imposed a facilities fee to finance the construction of certain water system facilities required for new development. The court held the fee was a “special tax” because the district failed to prove the fee did not exceed the reasonable cost of providing the service for which the fee was imposed. The court determined, “[s]uch a showing would require, at a minimum, evidence of (1) the estimated construction costs of the proposed water system improvements, and (2) the District’s basis for determining the amount of the fee allocated to plaintiff, i.e., the manner in which defendant apportioned the contemplated construction costs among the new users, such that the charge allocated to plaintiff bore a fair or reasonable relation to plaintiff’s burden on, and benefits from, the system.” *Id.* at 234-35, referencing *Mills v. County of Trinity*, 108 Cal. App. 3d 656, 659-60 (1980); *County of Fresno v. Malmstrom*, 94 Cal. App. 3d 974, 983-85 (1979).

The plain language of the user fee exception indicates the City cannot require a payor to pay for a specific benefit or privilege that someone else receives for free or at a discount (i.e., a subsidy). This could, for instance, affect the City’s ability after November 3, 2010, to offer senior discounts or subsidized recreation passes. Nevertheless, we believe discounts are permissible if funded from non-fee revenues, such as the City’s general fund, because the language of the exception is “those not charged” rather than “those not charged in full.”

Further, this exception would likely allow the City to charge differently-situated individuals varying amounts for specific benefits or privileges so long as the charge paid by such individuals bears a fair or reasonable relationship to the benefit received by such individual.

3. Impact of the User Fee Exception on the City.

We anticipate the user fee exception will apply to fees associated with planning and police permits, franchises, and parking passes so long as those fees are limited to the cost of the permit program and the benefit or privilege “is not provided to those not charged.”

B. Government service or product exception

A fee “imposed for a specific government service or product provided 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 providing the service or product,” is not a tax. This language is nearly identical to that of the user fee exception, except it pertains to government services and products.

A “service” is “[a]n intangible commodity in the form of human effort, such as labor, skill, or advice.” Black’s Law Dictionary (7th ed. 1999). Services may include retail electricity, gas, and other utility service charges “imposed” by a local agency. Services may also be offered in connection with government-provided recreational, cultural, educational, and similar programs, such as tennis lessons and or art lectures.

A “product” is a “[s]omething that is distributed commercially for use or consumption and that is [usually] (1) tangible personal property, (2) the result of fabrication or processing, and (3) an item that has passed through a chain of commercial distribution before ultimate use or consumption.” Black’s Law Dictionary (7th ed. 1999).

As with user fees, the service or product must be provided to a discrete group, and not to those not charged, although a fee does not become a tax if the public as a whole is incidentally benefitted by the expenditure of the proceeds. *Weisblat v. City of San Diego*, 176 Cal. App. 4th 1022, 1038 (2009), referencing *Evans v. City of San Jose*, 3 Cal. App. 4th 728, 738 (1992); *Bay Area Cellular Telephone Co. v. City of Union City*, 162 Cal. App. 4th 686, 695 (2008).

Further, the charge must not exceed the reasonable cost of providing the service or product. Although an exact accounting for each product or service is not necessary, courts have consistently held that reasonably estimated costs are required to support a fee request. *See*, for instance, *California Association of Professional Scientists*, 79 Cal. App. 4th 935, 945 (2000); *Beaumont Investors v. Beaumont-Cherry Valley Water District*, 165 Cal. App. 3d 227, 234-35 (1985); and *Sinclair Paint Company v. State Board. of Equalization*, 15 Cal. 4th 866, 874 (1997). The amount of the charge should generally relate to the actual goods or services provided. *Isaac v. City of Los Angeles*, 66 Cal. App. 4th 586, 597 (1998).

We believe service fees exempt from Proposition 26 include utility fees not subject to Proposition 218; park and recreation fees that are not admission or equipment rental fees; transit fees; emergency response fees under Government Code sections 53150 through 53159; and inter-governmental charges, such as property tax administration fees⁶.

C. The regulatory fee exception

Proposition 26 addressed what some characterized as an undesirable result in the case of *Sinclair Paint Co. v. State Board of Equalization*, 15 Cal. 4th 866 (1997). *Sinclair* upheld as a bona fide regulatory fee an assessment imposed on a paint company that shifted the cost of providing evaluation, screening, and medically-necessary follow-up services to potential child victims of lead poisoning from the public to those responsible for the poisoning (i.e., the paint companies). Thus, according to *Sinclair*, a local agency could impose fees to regulate *and* mitigate the social and economic impacts of a fee payor's activities as long as regulation is the primary purpose. *Sinclair Paint, supra*, 15 Cal. 4th at 880.

Under Proposition 26, any regulatory fee, or any portion of a regulatory fee, imposed to mitigate the past, present, or future adverse impact of the fee payors's operations, and regulatory fees imposed to raise revenue for a new program, is a tax. Further, the fee imposed must not recover more than the cost incurred by the local agency in providing the benefits, privileges, service, or product. *Weisblat v. City of San Diego*, 176 Cal. App. 4th 1022, 1041- 42 (2009).

Proposition 26 expressly exempts charges imposed for regulatory purposes such as "costs to a local government for issuing licenses and permits, performing investigations, inspections, and audits . . . and the administrative enforcement and adjudication thereof." Cal. Const. art. XIII C, § 1(e)(3).

1. What is a Regulatory Purpose Under this Exception?

A city is authorized to impose fees, charges, and rates under its police power for regulatory purposes so long as the local enactments do not conflict with general laws. Cal. Const. art. XI, § 7. A regulatory purpose for which a fee may be imposed is a government program that protects the health and safety of the public. *California Association of Professional Scientists v. Department of Fish & Game*, 79 Cal. App. 4th 935, 950 (2000).

⁶ It is unclear whether the exception applies to booking fees since booking fees are charged for a service that is sometimes provided to persons not charged.

Courts have held that permissible regulatory fees include fees designed to cover a county's reasonable costs for processing land use permits and applications; fees on rental units to defray the costs of the administrative hearing process under a rent control ordinance; and fees on existing signs to recover the costs of administering a sign control ordinance. 85 Op. Cal. Att'y Gen. 21 (2002). We also anticipate this exception will cover a wide range of local government regulatory fees such as building permit fees, fire inspection fees, weed abatement assessments, and alarm permit fees. Finally, a fee can be used to pay for rule-making associated with a regulatory program. *See*, Proposition 26 Ballot Measure, Arguments in Favor of Proposition 26.

Local agencies should carefully examine fees that serve more than one purpose. Although regulatory fees that broadly benefitted the public were permissible before the passage of Proposition 26, regulatory fees imposed to mitigate past, present, or future adverse impacts caused by a fee payor's operations, or to raise revenue for a program, are taxes under Proposition 26 and require approval by two-thirds vote of local voters. If, for example, the City intends to increase an existing fee for "hazardous materials," the City must analyze whether the fee is based on the costs of inspection and of issuing a permit for storage of these materials (i.e., a benefit to the fee payor), or whether the fee or a portion of the fee is being used to promote pollution prevention or clean-up of toxic waste sites.

If a city imposes an inspection fee on businesses that operate surface parking lots, and some of the fee is used to ensure compliance with best management practices that prevent storm water run-off, and some is used fund a storm water prevention education program, the fee for the inspection is permissible under this exception, but the portion used to cover the cost of the education program is not permissible under this exception because it does not relate to inspections and enforcement provided to a specific fee payor.

While many fees may appear "regulatory," the manner in which the fee is calculated will determine whether it fits into the regulatory exception.

2. What are reasonable regulatory fees?

Proposition 26 requires a fair or reasonable relationship between the regulatory fee and the payor's burdens on, or benefits received from, the governmental activity. Regulatory fees "must not exceed the reasonable cost of the services necessary for the activity for which the fee is charged and for carrying out the purpose of the regulation; they may not be levied for unrelated purposes." *Isaac v. City of Los Angeles*, 66 Cal. App. 4th 586, 596 (1998); also *see Garrick Development Co. v. Hayward Unified School District*, 3 Cal. App. 4th 320, 329-30 (1992).

The method of calculating regulatory fees is well stated in *United Business Commission v. City of San Diego*, 91 Cal. App. 3d 156, 165-166 (1979):

The general rule is that a regulatory license or permit fee levied cannot exceed the sum reasonably necessary to cover the costs of the regulatory purpose sought. Such costs, however, include all those incident to the issuance of the license or permit, investigation, inspection, administration, maintenance of a system of supervision and enforcement. (citation omitted). The Supreme Court in *County of Plumas v. Wheeler, supra*, 149 Cal. at 764, explained: "It is not to be understood from these citations that the costs to the municipality which may be considered are simply those which arise directly in the enforcement of the regulatory provisions themselves. The license fee may properly be fixed with a view to reimbursing the city, town, or county for all expense imposed upon it by the business sought to be regulated." In fixing upon the fee, it is proper and reasonable to take into account not the expense merely of direct regulation, but all the incidental consequences that may be likely to subject the public to cost in consequence of the business licensed. Finally, the municipality need only apply sound judgment and consider 'probabilities according to the best honest viewpoint of informed officials' in determining the amount of the regulatory fee. (citation omitted.)

If, on the other hand, a fee "is exacted solely for revenue purposes and its payment gives the right to carry on the business without any further conditions, it is a tax." *United Business Commission v. City of San Diego*, 91 Cal. App. 3d 156, 165 (1979), citing *City & County of San Francisco v. Boss*, 83 Cal. App. 2d 445, 450-51 (1948). "The determination of whether the actual purpose of an ordinance is regulatory or revenue-raising in nature is a question of fact. (citations). In its determination, the court will look to the substantive provisions of the ordinance and not merely its title and form." *United Business Commission v. City of San Diego*, 91 Cal. App. 3d 156, 165 (1979).

The *United Business Commission* case makes an important point. If challenged, a local agency's legislative documents in support of the fee are critical: staff must explain the link between the cost and the matter to be regulated and justify all fee calculations based on a study of the costs associated with the regulation at issue. Further, the local agency's approval of a fee should be based on the facts presented, and the basis for the decision must be documented.

D. Use of government property exception

This exception applies when a fee is charged for entry onto government-owned real property, use of government-owned personal property, or when real or personal government-owned property is sold, rented out, or leased. Unlike some of the other exceptions, a local agency is not required to limit its fees to a reasonable cost⁷. The City may use its discretion in setting a price. This price typically reflects what the market will bear.

This exception likely includes park and recreation entrance fees and equipment rental fees exclusive of services like lessons or trainings; leases of government property such as office space; and franchise fees⁸ for which rights to use government property are provided (i.e., for cable⁹, gas, electric, and oil and gas pipeline franchises).

E. Exception for fines and penalties

This exception concerns “[a] fine, penalty, or other monetary charge imposed ... as a result of a violation of law.” A “fine” is “a pecuniary criminal punishment or civil penalty payable to the public treasury;” a “penalty” is “a sum of money exacted as punishment for either a wrong to the state or a civil wrong (as distinguished from compensation for the injured party’s loss);” and a monetary charge is the price, cost, or expense that may include a delinquency charge, a finance charge, or a late charge. Black’s Law Dictionary (9th ed. 2010). We believe a “violation of law” will be broadly interpreted to include not just a state statute, but a City ordinance, regulation, or policy. *Empire Fire & Marine Insurance Company v. Bell*, 55 Cal. App. 4th 1410, 1419 1422 (1997).

Unlike some of the other Proposition 26 exceptions, the City is not required to limit its fines, penalties, or charges to a reasonable cost, nor must it establish a “fair and reasonable relationship” to a benefit or privilege provided. Fines and penalties for violations of law, whether categorized as criminal punishment or civil penalty, are punitive in character and are imposed as a means of securing obedience to statutes and regulations validly adopted under the police power. *People v. Union Pacific Railroad Company*, 141 Cal. App. 4th 1228, 1257-58 (2006); also see *Hale v. Morgan*, 22 Cal. 3d 388, 398 (1978). Thus, fines and penalties may be imposed

⁷ As discussed, Proposition 26 does not define “impose.” A fee is likely “imposed” when government is the sole provider, is required by law to provide the service or product, or the service is commonly provided by government. Voluntarily paying a fee or having choices in providers is likely not an imposition of a fee.

⁸ A franchise fee is compensation for the grant of right-of-way and a possessory right to use land so essential services can be provided to the public. *Santa Barbara County Taxpayer Association v. Board of Supervisors*, 209 Cal. App. 3d 940, 949 (1989).

⁹ California law provides for franchise fees, characterized as a “rent or toll,” to local government agencies for use of their property, and such fees are therefore exempt from Proposition 26. Cal. Pub. Util. Code § 5840(q)(1). In addition, the City has adopted a fee to support public, educational and governmental (PEG) channel facilities. SDMC § 73.0202(b). Proposition 26 may be triggered if the PEG fee ordinance expires and must be reauthorized.

without regard to actual damage that may have been sustained, and need not have a “fair and reasonable relationship” to a benefit or privilege provided. *People v. Union Pacific Railroad Company*, 141 Cal. App. 4th 1228, 1257-1258 (2006).

This exception includes parking fines, administrative penalties imposed as described in the San Diego Municipal Code, late payment fees, interest charges, and any “other monetary charge imposed by” the City “as a result of a violation of law.”

F. A charge imposed as a condition of property development is not a tax requiring approval by two-thirds vote of local voters

Charges imposed by the City as a condition of property development are an exception to Proposition 26. Local agencies, including the City, impose charges to mitigate the effects of development. Charges imposed as a condition of development are already regulated by the California Constitution and other state laws such as the Mitigation Fee Act which require a “logical nexus” between the charge and the burden posed by the development. Cal. Gov’t Code § 66000, *et seq.*; *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987).

When determining whether a fee relating to property development is a tax or a fee, it is important to distinguish fees that are conditions of property development from fees that do not necessarily involve property development. For example, a water capacity charge is similar to a development fee in that it is imposed only in response to a property owner’s voluntary application to a public entity. It is different in that the application may only be for a water service connection “without necessarily involving any development of the property.” In such a case, the water capacity charge would not be exempt from Proposition 26 under this exception. *Richmond v. Shasta Community Services Dist.*, 32 Cal. 4th 409 (2004).

This exception likely extends to any fee or charge imposed as a condition of property development, including permit and inspection fees, and fees to recover the cost of advance planning services such as building permit surcharges. As is permitted by the Mitigation Fee Act, the City imposes facilities benefit assessments (FBAs) and development impact fees (DIFs) on new development in the City¹⁰. These assessments and fees are conditions of property development and are exempt.

G. Exception for assessments and property-related fees imposed in accordance with the provisions of Proposition 218

Proposition 26 does not apply to assessments and property-related fees subject to Proposition 218. This exception includes retail, but not wholesale, fees for government water,

¹⁰ FBAs are addressed in San Diego Municipal Code (SDMC) sections 61.2200, *et seq.*, and DIFs are addressed in SDMC section 142.0640 and in resolutions periodically adopted by Council for each separate community. FBAs are collected by placing a lien on undeveloped property, and DIFs are collected upon issuance of a building permit.

sewer, and trash services and other property tax roll fees such as those imposed for flood control and water quality programs. *Greene v. Marin County Flood Control and Conservation District*, 49 Cal. 4th 277 (2010). Increased assessments and fees subject to Proposition 218 require voter approval.

The City authorizes the levy and collection of assessment within a number of special assessment districts, including Business Improvement Districts (BIDs), Maintenance Assessment Districts (MADs), the Downtown Property and Business Improvement District (PBID), and the Tourism Marketing District (TMD). Assessments are levied upon either properties or businesses to pay for special benefits received from improvements and activities within the district. Assessments against real property, such as the City's PBID and MADs, are subject to the requirements of Proposition 218 and are therefore exempt from Proposition 26.

Assessments imposed on businesses to fund a variety of services to the districts in which these businesses operate are not subject to Proposition 218 because the assessment is not imposed on real property. Thus, neither BID nor TMD assessments fall within this exception¹¹. Cal. Sts. & High. Code § 36500, *et seq.*; *Howard Jarvis Taxpayers Association v. City of San Diego*, 72 Cal. App. 4th 230 (1999).

II. PRACTICAL CONSIDERATIONS AS THE CITY EVALUATES NEW, INCREASED, OR CONTINUED FEES

Although Proposition 26 will be defined by the Courts over time, there are some practical considerations City staff should bear in mind:

1. Seek legal review. No existing City fee should be increased, renewed, or imposed without first seeking legal review from the City Attorney's Office. Increased fees may be permissible if they fall within one of the seven exceptions to Proposition 26, but such determination should be supported by legal analysis. Further, City staff should not request Council renewal of existing and unchanged fees. This sometimes occurs when a department seeks approval and adoption of a comprehensive fee schedule. Renewing an existing and unchanged fee could unnecessarily raise Proposition 26 issues.
2. CPI escalators may be okay. Some fees may sunset or include a consumer price index (CPI) escalator. A fee that sunsets and is not reapproved before November 3, 2010 must be reviewed under Proposition 26. A CPI escalator likely is not subject to Proposition 26 so long the City Council approved the fee and the CPI escalator prior to November 3, 2010¹².

¹¹ BID and TMD assessments may fall under the "service" exception because the City provides services to a business district in exchange for payment.

¹² In addition, California Government Code section 53750(h)(2)(A) exempts automatic inflation adjustments.

3. Pre-Proposition 26 Tax Rules are Unchanged. Proposition 26 does not alter the rule that a tax increase or extension is subject to voter approval requirements. Thus, as was the case before Proposition 26, any increases to the business license tax or the transient occupancy tax would require approval by a two-thirds vote. Property-related fees imposed in accordance with Proposition 218 continue to follow those rules.
4. Fee Studies are Necessary to Employ Certain Exceptions. Departments imposing, increasing, or extending fees after November 3, 2010, are required to do a fee study in support of their proposed fee if they claim the user fee, government service/product fee, or regulatory fee exception to Proposition 26. Such fee cannot exceed the reasonable cost associated with the fee. The methodology for computing a reasonable fee is discussed with respect to each exception. In any event, City staff must be able to prove their calculations to the satisfaction of the City Council and the public. The legislative record should reflect these calculations and there should be concrete evidence in support of the calculations, as the local agency has the burden of establishing a fee is appropriate if challenged. Departments are not required to prove the reasonableness of fees associated with the entrance or use of local government property, penalties, or property development.
5. Consider Negotiated Fee Agreements. Departments should consider establishing fee obligations by agreement rather than by legislation where practical.
6. Unfunded State Mandates. A state mandate is unfunded if the local agency must rely on a vote to pay for the program. As Proposition 26 will require local agencies to bring more funding measures to the voters, the City should document expenses associated with Proposition 26 in the event there is an opportunity for reimbursement from the State.

CONCLUSION

The impact and meaning of Proposition 26 is not entirely clear. Most of the City's fees fall squarely within one or more of the seven exceptions. Nonetheless, it is important to work closely with legal counsel before imposing any new, increased, or extended fees.

The City Attorney's Office is currently reviewing City of San Diego Administrative Regulation No. 95.25 entitled "Processing new and revised fees and charges for current services;" Council Policy 100-05 (User Fee Policy); the Clerk's Comprehensive Fee Schedule; and the City's risk management policies and procedures, in order to determine whether any of

Honorable Mayor and
City Council

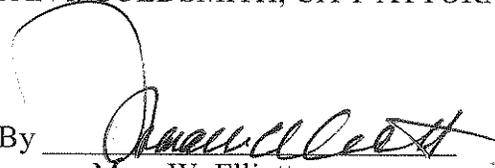
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March 4, 2011

these documents need to be revised in light of the passage of Proposition 26. We will continue to keep you apprised of significant legal developments associated with this new legislation.

JAN I. GOLDSMITH, CITY ATTORNEY

By

A handwritten signature in black ink, appearing to read "Mara W. Elliott", written over a horizontal line.

Mara W. Elliott
Deputy City Attorney

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ML-2011-3