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MEMORANDUM OF LAW

DATE: June 19, 2014

TO: Honorable Mayor and City Councilmembers

FROM: City Attorney

SUBJECT: Contracting Procedures and Other Issues Relating to the City's Provision of Economic Development Subsidies

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INTRODUCTION

On June 23, 2014, the San Diego City Council (Council) will consider the approval of two contracts: (1) the Economic Development Agreement between the City and Home Brew Mart, Inc., dba Ballast Point Brewing & Spirits (Ballast Point); and (2) the Economic Development Agreement between the City and JDZ, Inc., dba AleSmith Brewing Company (AleSmith) (collectively, Incentive Agreements).[1] The City seeks to attract and retain Ballast Point and AleSmith (individually, Company, and collectively, Companies) in San Diego by offering financial incentives and expedited permitting services pursuant to the City's Business and Industry Incentive Program (Incentive Program) described in Council Policy 900-12.

On April 9, 2014, the Committee on Economic Development and Intergovernmental Relations considered the Incentive Agreements and requested that City staff and this Office review the applicability of the City's contracting provisions prior to the Council's consideration. This memorandum addresses the applicability of various contracting procedures and requirements, as well as other legal issues, implicated by the Incentive Agreements.[2]

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[1] Throughout this memorandum, the term "City" refers to the City of San Diego, a municipal corporation, and the term "San Diego" refers to the territory within the City of San Diego's geographical boundaries.

[2] This Office is not aware of any specific provision of State of California (State) law that either expressly permits or prohibits the awarding of public subsidies in the manner contemplated by the Incentive Agreements. Yet, the California Legislature recently enacted California Assembly Bill 562 (2013-2014 Reg. Sess.) (AB 562), which imposes certain noticing, disclosure, and reporting requirements on local agencies relating to the approval of a broad range of economic development subsidies. It is assumed for purposes of this memorandum that the Incentive Agreements are generally permissible under State law, as implicitly recognized in the enactment of AB 562. Rather than focusing on general legal permissibility, this memorandum undertakes a fact-specific analysis

QUESTIONS PRESENTED

1. Must the Companies comply with various contracting procedures and requirements due to the City's provision of financial benefits to the Companies under the Incentive Agreements? More specifically:

a. Are the Companies subject to the City's competitive contracting procedures?

b. Are the Companies subject to the City's Equal Employment Opportunity Programand the City's "Nondiscrimination in Contracting" rules?

c. Are the Companies subject to the City's Equal Benefits Ordinance?

d. Are the Companies subject to the City's Living Wage Ordinance?

e. Are the Companies subject to prevailing wage laws?

2. Is the Cityrequired to comply with certain noticing, disclosure, and reporting requirements under AB 562 in connection with the Incentive Agreements?

3. Does the Incentive Program, as well as the City's award of the Incentive Agreements to the Companies, violate general principles of equal protection?

4. Does the City's provision of financial assistance under the Incentive Agreements constitute an impermissible gift of public funds?

5. Will the City's provision of financial assistance under the Incentive Agreements violate Propositions 218 or 26?

6. Will the City's rebate of sales taxes to the Companies, as identified in the Incentive Agreements, violate the State law that prohibits one local public agency from luring a business away from another local agency by offering certain tax-based financial incentives?

SHORT ANSWERS

1. Contracting Procedures and Requirements:

a. Competitive Contracting: No. The Companies are not subject to the City's competitive contracting procedures regarding the selection of contractors to construct their development projects on privately-owned propertybecause the Incentive Agreements are not "public works contracts" and instead contemplate private development activity.

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regarding compliance with the City's procedures and regulations, as well as compliance with several legislative bills and legal principles, in connection with the Incentive Agreements. Anychanges in the factual circumstances surrounding the Incentive Agreements, or anysimilar agreements of this nature awarded in the future, could result in legal conclusions that differ from the discussion in this memorandum.

b. Equal Employment and Nondiscrimination: No. The Companies are not subject to the Equal Employment Opportunity Program because the Companies are not contractors, and the Incentive Agreements are not contracts, within the meaning of the pertinent provisions of the San Diego Municipal Code (Municipal Code or SDMC). The Companies also are not subject to the City's Nondiscrimination in Contracting rules because the Incentive Agreements are not contracts under the pertinent provisions of the Municipal Code.

c. Equal Benefits Ordinance: No. The Companies are not subject to the City's Equal Benefits Ordinance because the Incentive Agreements are not within the relevant definition of a contract.

d. Living Wage Ordinance: No. The Companies are not subject to the City's Living Wage Ordinance because, in each instance, the Incentive Agreement does not have a combined value of $500,000 or more over a period of five years.

e. Prevailing Wage Requirements: No. The provision of public subsidies to the Companies is likely to convert the development projects into "public works" for purposes of determining applicability of prevailing wage laws. However, the development projects qualify for an exemption from prevailing wage laws applicable to any private development project where the subsidy amount is de minimis in comparison to the overall project costs.

2. AB 562: Yes. AB 562, enacted in October 2013, imposes certain noticing, disclosure, and reporting requirements with respect to any local agency's award of a broad array of economic development subsidies. The Incentive Agreements provide for the type of economic development subsidies identified in AB 562, above the minimum statutory threshold of $100,000. Thus, the City must comply with the requirements of AB 562.

3. Equal Protection: Likely not. The City's current Incentive Program likely complies with general principles of equal protection because it does not involve inherently suspect classifications or fundamental rights and sets forth objective eligibility criteria that are rationally related to the Incentive Program's stated goals. Similarly, the City's selection of the Companies for the award of financial incentives in accordance with the objective eligibility criteria in the Incentive Program likely complies with general principles of equal protection.

4. Gift of Public Funds: No. The City's provision of financial incentives to the Companies will not constitute an impermissible gift of public funds so long as the Incentive Agreements involve an exchange of adequate consideration and the incentives achieve one or more public purposes. The pertinent staff reports describe the exchange of consideration and the public purposes associated with the Incentive Agreements. The Council will be asked to adopt a finding of public purpose in connection with the Incentive Agreements.

5. Propositions 218 and 26: No. The City's reimbursement of development-related fees to the Companies under the Incentive Agreements will not violate Propositions 218 or 26 because the City's reimbursement will be derived from the City's General Fund and will not cause other development applicants to pay increased amounts of fees to the City.

6. Sales Tax Revenue: No. The City's rebate of local sales taxes to the Companies will not result in a loss of sales tax revenue to another jurisdiction in violation of State law. The Companies presently operate their breweries in San Diego, such that the City's provision of incentives to the Companies will not lure them away from another jurisdiction.

BACKGROUND

A. City's Incentive Program

The goal of the Incentive Program is to attract and retain major revenue, job generating, and revitalization projects throughout San Diego. By offering assistance to private businesses, financial or otherwise, the City can incentivize projects that promote a sound and healthy economy, promote the stability and growth of City taxes and other revenues, encourage new businesses and other appropriate development in older parts of San Diego, and respond to other jurisdictions' efforts to induce businesses to relocate from San Diego. Council Policy 900-12.

The City has often used the Incentive Program, on an administrative basis (i.e., without the Council's approval), to provide qualifying businesses with certain types of incentives, such as permit processing assistance and credits or rebates for sales and use taxes up to specified limits. However, the City has seldom used the Incentive Program to provide qualifying businesses with other types of incentives requiring the Council's approval, such as the reimbursement of development-related fees, the rebate of the City's portion of real and personal property taxes, and the provision of tax-exempt bond financing. City staff is aware of four examples where the Council approved the provision of subsidies to local businesses under the Incentive Program. Two notable examples are summarized below. In 1998, the City entered into an incentive agreement with Novartis for the construction and development of a research and development industrial complex. Novartis completed its project and received a full reimbursement of housing impact fees in the amount of $172,000 paid prior to development. In 2001, the City entered into an incentive agreement with IDEC Pharmaceuticals (IDEC) for the construction and development of a corporate headquarters and research and development industrial complex. The City awarded to IDEC a potential reimbursement of development-related fees totaling $614,000. Though IDEC constructed the project, IDEC did not generate tax revenues for the City that qualified toward the reimbursement calculation, and the City ultimately provided no reimbursement. IDEC abandoned the complex in 2011. The complex is presently leased by a different biotechnology company.

B. Proposed Incentive Agreements

The City now proposes to use the Incentive Program to encourage the retention and growth of the Companies in San Diego. Each Company operates its manufacturing facilities in San Diego and plans to move into expanded manufacturing facilities at a different location in San Diego instead of moving to a neighboring jurisdiction. Each Company intends to convert a vacant factory building into a new beer manufacturing plant (commonly known as a brewery) at a new site in the Miramar area of San Diego and to operate several accessory uses at the new site, such as a restaurant, tasting room, gift shop, distribution warehouse, creamery, and administrative offices. The new Ballast Point facility will encompass approximately 120,000 square feet of building space, including the recent addition of a large office mezzanine, at 9045

Carroll Way in San Diego. The new AleSmith facility will encompass approximately 106,000 square feet of building space at 9990 Empire Street in San Diego.

The Incentive Agreements require the City to reimburse each Company for all fees paid to the City before a specified date – by June 30, 2014, for Ballast Point, and by December 31, 2015, for AleSmith – in connection with their respective development projects for expansion of brewery operations, as more specifically identified in each Incentive Agreement (individually, a Project or collectively, the Projects). The reimbursable fees paid by the Companies will consist of Facilities Benefit Assessment fees (FBA Fees) and costs associated with plan check, inspection, and other cost recovery fees charged by the City in connection with development (Permit Processing Fees). City staff anticipates that the aggregate total of the reimbursable FBA Fees and Permit Processing Fees (collectively, Development Fees) will be approximately $162,000 for Ballast Point and an amount not to exceed $180,000 for AleSmith.

As with the prior incentive agreements, the City will be obligated to reimburse the Development Fees to each Company only in an amount corresponding to the tax revenues generated directly by each Project and after the City's receipt of those tax revenues.[3] The reimbursable portion of the tax revenues will consist of all or a portion of the City's share of real and personal property taxes and sales and use taxes constituting tax revenues that the City would not otherwise collect but for the Projects. The City's reimbursement of the Development Fees to the Companies is authorized under Section B of Council Policy 900-12, which allows the City to reimburse certain types of City-imposed fees, including the Permit Processing Fees, FBA Fees, and Housing Impact Fees, utilizing future revenues to the City generated from the Projects after the City's receipt of those revenues.[4] Consistent with Council Policy 900-12, the City also proposes non-monetary assistance for the Projects, such as expedited permitting services and designated staff as a primary point of contact.

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[3] San Diego Charter (Charter) section 99 states, in part: "No contract, agreement or obligation extending for a period of more than five years may be authorized except by ordinance adopted by a two thirds' majority vote of the members elected to the Council after holding a public hearing which has been duly noticed in the official City newspaper at least ten days in advance." The City's completion of full reimbursement to the Companies under the Incentive Agreements is expected to take three to four years, but may extend beyond five years. The Incentive Agreements do not expire on a specified date. Therefore, this Office has advised that the City should comply with the above-quoted requirement in Charter section 99 in connection with approval of the Incentive Agreements.

[4] As evidenced by a contract already executed by the City and Ballast Point in November 2013, the City determined Ballast Point to be exempt under Municipal Code section 98.0618 from payment of Housing Impact Fees in the estimated amount of approximately $15,300 related to the construction of the office mezzanine, which added over 13,000 square feet of building space. AleSmith is not proposing to add any square footage to its new facility at this time, and thus is not expected to incur any Housing Impact Fees in connection with its Project.

DISCUSSION

I. THE COMPANIES ARE NOT SUBJECT TO VARIOUS CONTRACTING PROCEDURES AND REQUIREMENTS OF THE CITY BY VIRTUE OF EXECUTING THE INCENTIVE AGREEMENTS WITH THE CITY.

A. The Companies Are Not Subject to the City's Competitive Contracting Procedures Regarding Selection of Contractors to Construct the Projects Because the Incentive Agreements Are Not Public Works Contracts and Instead Contemplate Private Development Activity

The City has competitive contracting procedures for public works contracts and non-public works contracts, including contracts for goods and services as well as consultant contracts.[5] If the City enters into any of these types of contracts directly with a third party, the City must award the contract through a competitive process unless an exception applies in Chapter 2, Article 2, Divisions 30 through 36 of the Municipal Code. Here, the issue is whether the City's competitive contracting procedures will apply to the Companies in carrying out their respective Projects if the parties execute the Incentive Agreements, under which the City will reimburse the Companies for the Development Fees paid to the City with respect to the Projects.

1. Public Works Contracts

Public works contracts are subject to the competitive bidding procedures and requirements set forth in Charter section 94 and Chapter 2, Article 2, Divisions 30 through 36 of the Municipal Code. The Charter requires that, "[i]n the construction, reconstruction or repair of *public buildings, streets, utilities and other public works*," the Council must award contracts over a specified amount to the "lowest responsible and reliable bidder, not less than ten days after advertising for one day in the official newspaper of the City for sealed proposals for the work contemplated." Charter § 94 (emphasis added). To implement the Charter, the Municipal Code imposes numerous requirements related to public works contracts, including requirements for advertisement, competitive bidding, and awarding of such contracts. SDMC §§ 22.3004, 22.3011, 22.3102, 22.3106, 22.3107. For this purpose, a "public works contract" means "a contract for the construction, reconstruction or repair of public buildings, streets, utilities and other public works, including design-build contracts, construction manager at risk contracts, and *job order contracts*."[6] SDMC § 22.3003. Certain contracts are exempt from competitive bidding requirements. *Id.* § 22.3108.

In this instance, the issues are: (1) whether a contract between each Company and a contractor for private construction work related to a Project that will be paid for solely with

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[5] "All contracts shall be awarded through a competitive process unless otherwise provided in [Chapter 2, Article 2, Division 32 of the Municipal Code]." SDMC § 22.3202. Division 32 only addresses contracts for services, goods, and consultants. Thus, despite the broad language in this Municipal Code section, this Office interprets the section to apply only to the contracts identified in Division 32 and not to all City contracts. Consistent with this interpretation, the competitive contracting procedures do not apply to the City's decision to enter into the Incentive Agreements in the first instance because the Incentive Agreements do not constitute contracts for goods or services, or consultant contracts, within the meaning of Division 32. Nonetheless, the City's award of the Incentive Agreements may implicate general principles of equal protection, as discussed in Part III of this memorandum.

[6] Unless otherwise specified, words in italics refer to defined, italicized terms in the Municipal Code.

Company funds, except for any reimbursement of Development Fees payable under the Incentive Agreement, is a "public works contract" within the meaning of the Municipal Code; (2) whether construction work related to a Project is a "public work" within the meaning of the Charter; and (3) whether the City's competitive bidding procedures therefore apply to that contract.

Although the term "public work" is not expressly defined in either the Charter or the Municipal Code, the portions of those documents that govern the City's competitive contracting procedures illustrate the meaning of a public work. As described above, the Charter discusses competitive bidding for "the construction, reconstruction or repair of public buildings, streets, utilities and other public works." Charter § 94. Utilizing identical language, the Municipal Code defines a "public works contract" as "a contract for the construction, reconstruction or repair of public buildings, streets, utilities and other public works . . ." SDMC § 22.3003. Accordingly, a public work is equivalent to a public improvement, including infrastructure.[7]

The purpose of the Incentive Agreements is to retain the Companies in San Diego and to promote the growth of their current business model due to their proven major revenue and job generation, as well as the revitalization offered by the Projects. The Incentive Agreements require the City to reimburse the Companies for the Development Fees using future tax revenues to be paid by the Companies as a result of their real property improvements and operation of beer manufacturing plants with retail components at the Project sites. The Incentive Agreements do not contemplate that the City will directly or indirectly fund – through payment, reimbursement, or similar benefits – any improvements constituting the Projects; nor do the Incentive Agreements involve a delegation to the Companies of any of the City's contracting functions for public works. Moreover, to the extent that the Companies will be required to complete any public or private improvements in connection with the Projects, the Incentive Agreements neither impose such requirements nor specify the City's payment or reimbursement – whether direct or indirect – toward such costs.

The most reasonable conclusion is that any private construction work associated with the Projects would not be considered a public work, as this term is used in the Charter or the Municipal Code, because the work would be paid for with private funds and would not be performed on publicly-owned property or infrastructure. Any construction work or improvements arising under the Projects would involve the private affairs or commercial enterprises of the Companies. Thus, the City's competitive bidding procedures should not apply to the Companies with respect to their selection of contractors to perform the construction work related to the Projects.

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[7] This Office has concluded that the City's contracting requirements would apply to a private developer acting as the City's agent in contracting for the design and construction of public improvements. 2011 City Att'y MOL 147 (2011-8; July 5, 2011). In reaching this conclusion, we employed the commonly applied definition of "public improvements" to describe "public works" and determined that public improvements are improvements upon the property of a municipality which serve to further the operation of the municipal government and the interest and welfare of the public, but do not include private affairs or commercial enterprises. *Id*, *citing* 13 McQuillin Mun. Corp. § 37:1 (3d ed. 2011).

2. Goods and Services Contracts and Consultant Contracts

The Municipal Code also sets forth competitive bidding procedures for two categories of contracts, namely contracts for goods or services and consultant contracts.[8] As to the first category, the Municipal Code states: "Except as otherwise provided . . . *contracts for goods* and *contracts for services* shall be awarded through a competitive process based on the estimated amount of City funds to be paid to the winning *bidder* under the contract." SDMC § 22.3203. The Municipal Code sets forth advertising requirements for goods and services contracts, which increase with the contract dollar amount. *Id*. As to the second category, Municipal Code section 22.3207 sets forth provisions regarding the award of consultant contracts. Moreover, competitive bidding requirements for consultant contracts are set forth in Council Policy 300-07 (Consultant Services Selection) and accompanying Administrative Regulations 25.60 (Selection of Consultants for Work Requiring Licensed Architect and Engineering Skills) and 25.70 (Hiring of Consultants Other Than Architects and Engineers). Council Policy 300-07 requires that the selection of consultants "be made from as broad a base of applicants as possible and . . . based on demonstrated capabilities or specific expertise." This Council Policy also specifies that a minimum of three consultants should be considered when possible, and that procurements should be advertised in the City's official newspaper for consultant contracts in excess of $25,000.

The Companies will need to enter into goods and services contracts as well as consultant contracts in order to complete the Projects. The Companies will contract directly with third parties and will neither act as an agent of the City nor pay for such contracts using the City's subsidies or other City funds. In other words, the Companies will enter into such contracts as private affairs or commercial enterprises, without City involvement. For these reasons, the City's competitive bidding requirements associated with these types of contracts should not apply.

B. The Companies Are Not Subject to the City's Equal Employment Opportunity Program Because the Companies Are Not Contractors, and the Incentive Agreements are Not Contracts, Within the Meaning of the Pertinent Municipal Code Provisions

The Equal Employment Opportunity Program (EEO Program) is intended "to ensure that contractors doing business with or receiving funds from the City will not engage in unlawful discriminatory employment practices prohibited by State or Federal law." SDMC § 22.2701. Although the Companies are executing the Incentive Agreements with the City, and ultimately may receive funds from the City, a literal reading of the definitions of "contract" and "contractor" provided in the context of the EEO Program strongly suggests that the EEO Program does not apply to the Incentive Agreements.

In order to address the applicability of the City's EEO Program, it is important to consider the general purpose of the Incentive Agreements and the specific obligations of each party under the Incentive Agreements. First, pursuant to the Incentive Agreements, the City

[8] A "contract for goods" means "a contract for the purchase of articles, commodities, materials, supplies, equipment, or insurance." SDMC § 22.3003. A "contract for services" means "a contract to provide assistance, labor or *maintenance* . . . [but] does not include *consultant contracts, contracts for goods,* or *public works contracts.*" *Id.* A "consultant contract" means a contract to provide expert or professional services including, but not limited to, accounting, architectural, engineering, marketing, public relations, management, financial, and legal services." *Id.*

agrees to process the Companies' permit applications on a priority basis. In order to receive this benefit, the Companies must deliver permit plans, applications, and related documents in accordance with the Incentive Agreements, including requirements such as application timing, verification of eligibility, and location of delivery. Aside from the standard permit fees, the Companies are not required to pay for this expedited service, and the City has the obligation to provide services as indicated, on the condition that the Companies meet the criteria set forth in the Incentive Agreements. Second, the City agrees to reimburse each Company for the actual amount of Development Fees paid to the City in connection with the applicable Project. The amount and timing of the reimbursement are dictated by a credit formula contained in the Incentive Agreements. The reimbursable taxes under the credit formula generally consist of previously uncollectable tax revenues generated directly by the Project and paid to the City on a future date. Each Company has no obligation to generate new tax revenues. If a Company does not generate tax revenues that result in a reimbursable amount under the credit formula, the City is not obligated to provide any payment to the Company.

A "contract" is defined in the EEO Program as "an agreement to provide labor, materials, supplies or services in the performance of a contract, franchise, concession or lease granted, let or awarded by or on behalf of the City." SDMC § 22.2702. The Incentive Agreements do not obligate the Companies to provide labor, materials, supplies, or services for the City's benefit. In fact, the Incentive Agreements do not obligate the Companies to engage in any particular activity. Instead, the Incentive Agreements offer the incentives of priority permit processing and reimbursement of Development Fees if the Companies fulfill specified criteria related to the generation of tax revenues from the Projects. Thus, it is unlikely that the Incentive Agreements fit within the pertinent definition of a "contract" under the Municipal Code.

A "contractor" is defined in the EEO Program as any entity "who is selected to enter into, or actually enters into a contract with . . . the City for public works or improvements to be performed, or for a franchise, concession or lease of property, or for goods, services or supplies to be purchased, at the expense of the City or to be paid out of [City funds]." SDMC § 22.2702. Although the Incentive Agreements refer to both the construction of improvements and the acquisition of a property interest by the Companies, such activities are identified for purposes of calculating a potential future tax rebate. The Incentive Agreements do not require or otherwise control the construction of improvements or the acquisition of property interests. If the Companies fail to complete any improvements or to acquire any property interests, the City has no contractual remedy against the Companies. Thus, it is unlikely that the Companies fit within the pertinent definition of a "contractor" under the Municipal Code.

As discussed above, it is unlikely that the Incentive Agreements are contracts, or that the Companies are contractors, for purposes of the Municipal Code provisions governing the EEO Program. Accordingly, the most reasonable conclusion is that the EEO Program does not apply to the Companies by virtue of their execution of the Incentive Agreements.[9]

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[9] It is also reasonable to conclude that the City's Nondiscrimination in Contracting rules, set forth in Chapter 2, Article 2, Division 35 of the Municipal Code, do not apply to the Companies in this instance. These rules seek to prevent the City from engaging in business with entities "that discriminate in the solicitation, selection, hiring, or treatment of subcontractors, vendors, or suppliers on the basis of race, gender, religion, national origin, ethnicity, sexual orientation, age, or disability. . . ." SDMC § 22.3501. The rules apply only to an entity that has been awarded a contract by or on behalf of the City "to provide labor, materials, goods, supplies, or services." *Id.* § 22.3502. As

C. The Companies Are Not Subject to the City's Equal Benefits Ordinance Because the Incentive Agreements Are Not Within the Pertinent Definition of a Contract in the Municipal Code

In 2010, the Council passed the Equal Benefits Ordinance (EBO), contained in Chapter 2, Article 2, Division 43 of the Municipal Code. The EBO is intended "to protect and further the public health, property, and welfare by requiring that the City contract only with *contractors* that offer the same employment benefits to employees with spouses and employees with *domestic partners*." SDMC § 22.4301.

The EBO applies to any "contract," defined as "any agreement between the *City* and another party for provision of goods, services, consultant services, grants from the *City*, leases of *City* property, or construction of public works." SDMC § 22.4302. As discussed in Part I.A above, the Incentive Agreements do not qualify as a "public works contract" within the meaning of the Municipal Code. As discussed in Part I.B above, the Incentive Agreements do not obligate the Companies to provide goods or services for the City's benefit.[10] The Incentive Agreements do not involve the lease of City-owned property. It is possible that the tax rebates offered in the Incentive Agreements could be construed as a "grant" from the City, which is an undefined term in the EBO. However, the tax rebates are structured as a conditional reimbursement owed to the Companies. The tax rebates are not grants within the traditional sense of a public agency's initial advance of funds to an entity in response to a competitive application process for the purpose of carrying out a specific project benefiting the agency or its constituency. Notably, a "grant" under the EBO is likely not as broad as a "financial assistance agreement" under the Living Wage Ordinance, as discussed in Part I.D below. The most reasonable conclusion is that the EBO does not apply to the Incentive Agreements and thus does not apply to the Companies.

D. The Companies Are Not Subject to the City's Living Wage Ordinance Because, in Each Instance, the Incentive Agreement Does Not Have a Combined Value of $500,000 or More Over a Period of Five Years

In 2005, the Council passed the Living Wage Ordinance (LWO), contained in Chapter 2, Article 2, Division 42 of the Municipal Code. The LWO "requires *covered employers* and their subcontractors to pay their employees a wage that will enable a full-time worker to meet basic needs and avoid economic hardship." SDMC § 22.4201. Covered employers must pay "the hourly wage rate and *health benefits rate* posted on the City's web site for that fiscal year[,]" provide a minimum amount of *compensated leave* and *uncompensated leave*, and pay the state prevailing wage rate if such rate is higher than the wage rate specified. *Id.* § 22.4220. Covered employers also must follow certain reporting and notification requirements, such as the inclusion of living wage provisions in applicable subcontracts, the filing of a living wage certification with the City within thirty days after becoming a covered employer, and the notification to employees

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discussed above, the Incentive Agreements do not obligate the Companies to provide labor, materials, goods, supplies, or services for the City's benefit.

[10] The Incentive Agreements require the City to deliver permit assistance and tax rebates to the Companies for the purpose of incentivizing business retention and expansion in San Diego. A more reasonable interpretation is that the EBO applies where a contractor provides services for the City's benefit, not where the City provides services for a contractor's benefit. Also, the City's provision of permit assistance pursuant to the Incentive Agreement is not associated with or in furtherance of any public works.

of their rights under the LWO. *Id.* § 22.4225. Various remedies are available to enforce the provisions of the LWO, including a civil lawsuit by a covered employee or an investigation and enforcement action by the City for any violation by a covered employer. *Id.* § 22.4230.

The LWO applies, among other things, to "any *financial assistance agreement* subject to the $500,000 threshold, including any applicable subcontract." *Id.* § 22.4210(a)(2). In pertinent part, a "financial assistance agreement" means "an agreement between the *City* and a *business* to provide direct financial assistance with the expressly articulated and identified purpose of encouraging, facilitating, supporting, or enabling . . . economic development, job creation, or job retention . . . ."[11] *Id.* § 22.4205. A financial assistance agreement includes "subcontracts to perform *services* at the site that is the subject of the *financial assistance agreement* or for the program that is the subject of the *financial assistance agreement.* . . ." *Id.* "As to economic development, job creation, or job retention, [the LWO] applies to *financial assistance agreements* with a combined value over a period of five years of $500,000 or more." *Id.* Any business receiving benefits under a financial assistance agreement for economic development must comply with the LWO "for a period of five years after the threshold amount has been received by the *business*." *Id.* § 22.4210(a)(2).

But for the monetary threshold of $500,000, the Incentive Agreements would qualify as "financial assistance agreements" for at least two reasons: (i) they contemplate direct financial assistance from the City to the Companies in the form of the City's reimbursement of development-related fees for the Projects; and (ii) they are intended to retain major revenue, job generating, and revitalization projects for the purpose of promoting economic development, job creation, or job retention. As such, the Incentive Agreements would trigger the need for the Companies to comply with the LWO's requirements if the financial assistance provided under each Incentive Agreement had a value of $500,000 or more over a period of five years. City staff has estimated that the City may provide total financial assistance to each Company of far less than one-half of the $500,000 threshold in connection with each Project. So long as the financial assistance provided under each of the Incentive Agreements will remain below the $500,000 threshold, the Companies will not be subject to the LWO's requirements.

E. The Companies Will Not be Subject to the Prevailing Wage Laws Because the City's Subsidies Fall Within an Established De Minimis Exemption

1. State Prevailing Wage Laws

State prevailing wage laws, California Labor Code sections 1720-1861, establish a scheme for determining and requiring payment of prevailing wages to workers employed on non-exempt public works projects. The statutory provisions require contractors and subcontractors on public works to: (1) pay workers at prevailing wage rates; (2) maintain and furnish certified payroll records; (3) hire apprentices in specified ratios for certain contracts; and (4) include certain prevailing wage provisions in subcontracts. Cal. Lab. Code §§ 1774, 1775(b)(1), 1776, 1777.5.

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[11] "Direct financial assistance" as used in this definition "includes funds, below-market loans, rebates, deferred payments, forgivable loans, land write-downs, infrastructure or public improvements, or other action of economic value identified in the *financial assistance agreement*." SDMC § 22.4205. However, it excludes "below-market leases to non-profit organizations or indirect financial assistance, such as that provided through broadly applicable tax reductions or services performed by *City* staff." *Id.*

At the State level, the Department of Industrial Relations (DIR) generally interprets, and the Division of Labor Standards Enforcement (DLSE) enforces, prevailing wage requirements.[12] When the DLSE determines that a violation of prevailing wage laws has occurred, the DLSE will issue a written Civil Wage and Penalty Assessment (CWPA) to a contractor or subcontractor. Cal. Lab. Code § 1741. An affected contractor or subcontractor may appeal any CWPA by filing a Request for Review. At a review hearing on the CWPA, the appellant "shall have the burden of proving that the basis for the [CWPA] is incorrect." *Id.* § 1742. If a violation of prevailing wage laws occurred, the offending contractor and subcontractors must pay the difference, including accrued interest, to workers who received less than the prevailing rate. *Id.* § 1741(a), (b). The offending contractor and subcontractors also may be subject to civil penalties (including daily monetary fines and debarment) and criminal penalties for violation of prevailing wage requirements. *Id.* §§ 1741(a), 1775, 1777.1, 1777.7. Further, under certain circumstances, the public agency awarding a public works contract may be subject to civil remedies and criminal penalties for violation of prevailing wage requirements.[13]

When a contract is awarded, the awarding body typically makes a coverage determination (i.e., a determination regarding applicability of prevailing wage requirements). Nonetheless, the DIR's Director is authorized to determine coverage under prevailing wage laws regarding either a specific project or the type of work to be performed. Cal. Code Regs. title 8, § 16001(a)(1). The DIR's coverage determinations are subject to judicial review. *Id.* §§ 16001-16002.5. If the DLSE issues the CWPA before the DIR has been asked to issue any coverage determination with respect to that same project, any affected contractor or subcontractor may timely request a review hearing to contest the CWPA. In that scenario, the affected contractor or subcontractor may raise a claim in the administrative review proceedings that either the project or the type of work performed is not subject to prevailing wage laws. Cal. Lab. Code § 1742.

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[12] The DLSE enforces prevailing wage requirements not only for the benefit of workers but also "to protect employers who comply with the law from those who attempt to gain competitive advantage at the expense of their workers by failing to comply with minimum labor standards." Cal. Lab. Code § 90.5(a); *see also Lusardi Construction Co. v. Aubry*, 1 Cal. 4th 976, 985 (1992).

[13] The City could incur two types of liability for awarding a contract for any public works to a contractor that fails to comply with prevailing wage requirements. First, a contractor may recover the difference between the wages actually paid to employees and the wages required under state prevailing wage laws, plus penalties and attorneys' fees, if the awarding body either: (1) represented to the contractor that the work to be covered by the contract was not a public work, or (2) received actual written notice from the DIR that the work is a public work, but failed to disclose that information to the contractor before awarding the contract. Cal. Lab. Code § 1726(c). Second, a contractor may recover any increased costs incurred after the award of the contract if a decision by the awarding body, the DIR, or a court classifies the work as a public work and the awarding body failed to identify the work as a public work under the contract documents. *Id.* § 1781(a)(1). An awarding body, however, would not be liable for such increased costs if: (a) the contractor did not directly contract with the body; (b) the body stated in its contract that the work was a public work to which prevailing wage requirements apply and obligated the private party to comply with prevailing wage requirements; and (c) the body fulfilled all of its duties, if any, under the California Civil Code or any other provision of law pertaining to the provision and maintenance of bonds to secure the payment of contractors, including the payment of wages to workers performing the work. *Id.* § 1781(a)(2). Finally, representatives of the awarding body could be found guilty of a misdemeanor for willful violation of prevailing wage requirements, or could be found guilty of a felony for taking or receiving, or conspiring to take or receive, prevailing wages owed to any worker on any public works. *Id.* §§ 1777, 1778.

2. Applicability of State Prevailing Wage Laws to Charter Cities

Traditionally, State prevailing wage requirements did not apply to charter cities on locally funded projects because charter cities were exempt from prevailing wage laws under the "home rule" provision in the California Constitution. *State Bldg. & Constr. Trades Council of Cal., AFL-CIO v. City of Vista*, 54 Cal. 4th 547, 558 (2012). In light of its status as a charter city, the City has not been required in the past to comply with the general laws of the State, including prevailing wage laws, in matters that are purely municipal affairs. *See Vial v. City of San Diego,* 122 Cal. App. 3d 346, 348 (1981).

Despite the fact that prevailing wage laws are municipal affairs and generally have not been applicable to charter cities, recent State and local legislation has broadened the applicability of these laws to charter cities. California Senate Bill 7 (2013-14 Reg. Sess.) (SB 7), signed by Governor Edmund G. Brown Jr. on October 13, 2013, effectively mandates that charter cities pay prevailing wages on local public works projects. SB 7 added California Labor Code section 1782, which disqualifies charter cities, as of January 1, 2015, from receiving or using State funding for construction projects unless they have adopted legislation that requires the payment of prevailing wages on all public works projects, with or without State funding.[14]

In response to SB 7, the Council adopted the Prevailing Wage Ordinance (PWO).[15] San Diego Ordinance O-20299 (Sept. 26, 2013); SDMC § 22.3019. The PWO incorporates the definition of "public works" found in State prevailing wage laws. SDMC § 22.3019(a). Under the PWO, the City shall require compliance with State prevailing wage requirements in relation to "contracts . . . awarded, entered into, or extended on or after January 1, 2014 . . . for construction work over $25,000 and for alteration, demolition, repair or *maintenance* work over $15,000." *Id.* § 22.3019(c). In applying State prevailing wage laws and determining the scope of any public works, the City may use the interpretive decisions from the DIR and a body of case law regarding prevailing wages that has developed over many years.[16]

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[14] This Office has previously advised that SB 7 is probably unconstitutional because, among other things, it appears to conflict with the "home rule" provision in the California Constitution. City Att'y MOL No. 2013-10 (June 17, 2013); City Att'y MOL No. 2013-18 (Nov. 19, 2013). In February 2014, with the assistance of the League of California Cities, six charter cities filed a lawsuit in San Diego County Superior Court to challenge SB 7. The challenge is based on multiple provisions of the California Constitution, including: (i) article XI, section 5(a) (Home Rule); (ii) article XIII, section 24(b) (Reallocation of Local Taxes); (iii) article IV, section 1 (Interference with the Reserved Power of the Voters); and (iv) article IV, section 16 (Special Legislation Applicable to Charter Cities). The lawsuit is currently in the pleading stage, and its outcome will likely decide the fate of SB 7. If the challengers succeed and SB 7 is found unconstitutional, the Council could choose to repeal or amend its own prevailing wage rules (discussed below) without forfeiting any ability to obtain State funding for local construction projects.

[15] Both before and after adoption of the PWO, the City has required compliance with (a) Federal labor wage laws for projects receiving Federal funds and (b) State prevailing wage laws for projects receiving State funds. Before adoption of the PWO, the City required compliance with State prevailing wage laws for projects not receiving State funds only with respect to water and sewer fund projects with estimated construction costs in excess of $10 million.

[16] The DIR's official website supplies access to letters and decisions on administrative appeals issued by the DIR's Director in response to requests for coverage determinations under the prevailing wage laws. However, in 2007, as a result of case law developments, the Director ceased designating any coverage determinations as precedential. *See* DLSE Public Works Manual § 2.7.1 (May 2013). Thereafter, the DIR has considered the coverage determinations to be advice letters directed to specific individuals or entities about whether a specific project or type of work is a public work subject to prevailing wage requirements. *Id.* According to the DIR, the coverage determination letters present the Director's interpretation of statutes, regulations, and court decisions on public works and prevailing wage coverage issues, and provide advice current only as of the date of each letter. *Id.*

3. Applicability of Prevailing Wage Laws to the Incentive Agreements

State law generally requires the payment of prevailing wages to workers employed on public works. Cal. Lab. Code § 1771. The term "public works" means "[c]onstruction, alteration, demolition, installation, or repair work done under contract and paid for in whole or in part out of public funds. . . . '[C]construction' includes work performed during the design and preconstruction phases of construction, including, but not limited to, inspection and land surveying work." *Id.* § 1720(a)(1). Prevailing wage requirements also are "applicable to contracts let for maintenance work." *Id.* § 1771.

California Labor Code section 1720(b) defines the phrase "paid for in whole or in part out of public funds" to mean all of the following:

> (1) The payment of money or the equivalent of money by the state or political subdivision directly to or on behalf of the public works contractor, subcontractor, or developer.
> …
> (4) Fees, costs, rents, insurance or bond premiums, loans, interest rates, or other obligations that would normally be required in the execution of the contract, that are paid, reduced, charged at less than fair market value, waived, or forgiven by the state or political subdivision.
> …
> (6) Credits that are applied by the state or political subdivision against repayment obligations to the state or political subdivision.

California Labor Code section 1720(c)(3) sets forth the statutory exemption from compliance with prevailing wage requirements pertaining to a public subsidy that is de minimis in the context of overall project costs for a private development project (De Minimis Exemption). The statute provides, in relevant part:

> If the state or a political subdivision reimburses a private developer for costs that would normally be borne by the public, or provides directly or indirectly a public subsidy to a private development project that is de minimis in the context of the project, an otherwise private development project shall not thereby become subject to the requirements of this chapter.

In this situation, the pertinent issues are whether the City's reimbursement of the Development Fees to the Companies constitutes the payment of public funds for construction of public works and, if so, whether the Projects are nevertheless exempt from prevailing wage requirements under the De Minimis Exemption.[17]

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[17] The applicability of prevailing wage requirements to the Companies is vitally important because City staff anticipates that payment of prevailing wages to all construction workers on the Projects would cause an increase in construction costs that would exceed the amount of Development Fees being reimbursed to the Companies. In this

a. Scope of "Public Works"

For public works status to attach to any work associated with the Projects, such work must be paid for in whole or in part out of public funds. Cal. Lab. Code § 1720(a)(1). The term "construction" is broadly interpreted in the prevailing wage context. *See Priest v. Hous. Auth. of the City of Oxnard*, 275 Cal. App. 2d 751, 754-756 (1969); *Lusardi*, 1 Cal. 4th at 987-989. The DIR has interpreted this term to include "activities integrally connected to the construction of the Project . . . without which the Project could not have been developed." PW 2002-047, *Legacy Partners Project City of Concord Redevelopment Agency* (Oct. 29, 2003), quoting PW 2000-011, *Town Square Project/City of King* (Dec. 11, 2000). "[T]he timing of the payment is not conclusive." PW 2002-040, *Advisory Opinion Re: Proposed Hotel Developments Under Senate Bills 975 and 972* (Jan. 16, 2003). "[S]ection 1720(b) only requires that public funds be spent on a project, not that those funds specifically fund the construction aspects of the project." *Id.*

As explained above, if the Companies complete the Projects and generate tax revenues emanating from the Project sites, the Incentive Agreements require the City to reimburse the Companies for the Development Fees paid to the City in connection with the Projects. The City's reimbursement is intended to incentivize and assist the Companies to locate, expand, and develop new breweries in San Diego at vacant factory building sites. Although nothing in the Incentive Agreements obligates the Companies to complete the Projects, the Companies plainly will be required to undertake construction work if they choose to complete the Projects in order to become eligible to receive reimbursement of Development Fees. Consequently, the City's reimbursement of Development Fees to the Companies would constitute the payment of public funds toward construction of public works, and would cause the Projects to be subject to prevailing wage requirements, unless the Projects are exempt on the basis that the amount of the City's subsidy in each instance is de minimis.

b. De Minimis Exemption

Enacted in 2001, California Senate Bill 975 (2001-02 Reg. Sess.) (SB 975) created the De Minimis Exemption from prevailing wage requirements. As described above, the De Minimis Exemption signifies that, where a public agency "provides directly or indirectly a public subsidy to a private development project that is de minimis in the context of the project, an otherwise private development project shall not thereby become subject to" prevailing wage requirements. Cal. Labor Code § 1720(c)(3). The legislative comment to SB 975 states: "This bill would provide that certain private . . . development projects built on private property are not subject to the prevailing wage, hour, and discrimination laws that govern employment of public works projects." 2001 Cal. Session Laws 5801 (West).

The applicability of the De Minimis Exemption in this instance turns on two issues. The first issue is whether each Project is a "private development project" – a phrase that is not defined in the statute. The Companies are private entities that conduct privately-funded business activities, with the exception of the City's reimbursement of Development Fees. The Project sites for the new, expanded breweries are privately owned. The City does not, and will not, have any

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sense, the Companies' receipt of the City's incentives could be counterproductive because these incentives could trigger payment of prevailing wages, which in turn could increase the overall Project costs for the Companies.

ownership interest in the Project sites, any operational or maintenance responsibilities for the Projects, or any equity interest in the Companies. Further, each Company will be motivated primarily to perform any construction at the Project site or otherwise within San Diego in order to accommodate the Company's private business operations and growth. These facts support the conclusion that any construction work performed by the Companies for the Projects would constitute a private development project within the meaning of the De Minimis Exemption.

The second issue is whether the amount of the City's reimbursement to each Company, which constitutes a subsidy toward the applicable Project, is de minimis within the context of the overall Project costs. The statute does not define "de minimis" or create a bright-line test for determining what level of subsidy fits within the De Minimis Exemption. As discussed below, there is precedent for applying the De Minimis Exemption to any project in which the total public subsidy is less than a certain minimal percentage of the total project costs. The DIR has observed that "de minimis" means "trifling; minimal . . . or so insignificant that a court may overlook it in deciding an issue or case." PW 2011-33, *Blue Diamond Agricultural Processing Facility – City of Turlock* (May 9, 2012), quoting Black's Law Dictionary 496 (9th ed. 2004). In interpreting whether a subsidy is de minimis, there has been a "[l]ongstanding practice . . . to view the subsidy in context of the project and use 2% as a general threshold for determinations." Governor's Veto Message, AB 302.[18] The DIR's Director has issued coverage determinations that generally comport with the 2 percent threshold expressed by the Governor; however, the highest percentage of total project costs found by the Director to be de minimis is 1.75 percent.[19] Conversely, the Director has found that a public subsidy equal to 5 percent or more of total project costs is not de minimis. PW 2002-040, *Advisory Opinion Re: Proposed Hotel Developments Under Senate Bills 975 and 972* (Jan. 16, 2003); PW 2009-036, *Construction of Gateway Retail Complex – City of Chula Vista, City of National City* (May 17, 2010).

Although there is no ironclad formula for calculating the total project costs that will serve as the denominator in the subsidy/project cost percentage under the De Minimis Exemption, at least two of the Director's coverage determinations have shed some light on this topic. In one case, the Director used a figure of $200 million to represent the total project costs, including direct construction costs, land acquisition, and other expenses. PW 2002-040, *Advisory Opinion Re: Proposed Hotel Developments Under Senate Bills 975 and 972* (Jan. 16, 2003). In another case, the Director applied a total cost figure representing "the cost of land acquisition and

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[18] In late 2013, the California Legislature overwhelmingly passed, but Governor Brown vetoed, California Assembly Bill 302 (2013-2014 Reg. Sess.) (AB 302), which would have statutorily defined the De Minimis Exemption. AB 302 would have provided that, with respect to any project advertised for bid, or any contract awarded, before January 1, 2014, the De Minimis Exemption applies only if the total public subsidy is less than $25,000 and less than 1 percent of the total project costs. In his veto message, Governor Brown expressed his strong support for the payment of prevailing wages, but remarked that AB 302 is too restrictive and would result in the De Minimis Exemption being applied to very few projects. It is possible that a future bill will be enacted with a less restrictive definition of the De Minimis Exemption, although it is likely that any future bill (like AB 302) would apply solely on a prospective basis to any bids advertised or any contracts executed after the effective date of the bill.

[19] The Director has found the following percentages of public subsidy to project costs, above a threshold of 1 percent, to qualify for the De Minimis Exemption: (1) 1.64 percent in PW 2004-024, *New Mitsubishi Auto Dealership, Victorville Redevelopment Agency* (Mar. 18, 2005); (2) 1.4 percent in PW 2007-12, *Sand City Design Center – Sand City Redevelopment Agency* (May 15, 2008); (3) 1.1 percent in PW 2008-037, *The Commons at Elk Grove – City of Elk Grove* (Jan. 2, 2009); (4) 1.2 percent in PW 2009-005, *Solar Photovoltaic Distributed Generation Facility – West County Wastewater District* (Apr. 21, 2010); and (5) 1.75 percent in PW 2011-033, *Blue Diamond Agricultural Processing Facility – City of Turlock* (May 9, 2012).

construction." PW 2009-036, *Construction of Gateway Retail Complex – City of Chula Vista, City of National City* (May 17, 2010).

Based on guidance from the DIR's Director, a reasonable method is to calculate the total project costs for each Project based on the sum of all construction, land acquisition, and other expenses that are functionally related and necessary for each Company to perform the Project.[20] It is unlikely that the Director would include any of the Companies' current obligations, such as current lease obligation costs, in the total project costs. Similarly, although guidance from the Director indicates that land acquisition costs are properly included in total project costs, it is unlikely that the Director would include the accumulation of all rental payments to be owed over the entire lease term in the total project costs; instead, the City should make a reasonable (and conservative) approximation of land acquisition costs.

The City's total subsidy toward the Projects should qualify for the De Minimis Exemption in both instances. In relation to Ballast Point, staff has estimated that the reimbursement of Development Fees will be approximately $162,000 and that the total project costs will be at least $13 million (but likely much more), resulting in a subsidy of 1.25 percent or less. In relation to AleSmith, staff has negotiated a "cap" of $180,000 on the reimbursement of Development Fees and has estimated that the total project costs will be approximately $12.7 million (but likely much more), resulting in a subsidy of 1.42 percent or less. Both percentages conservatively exclude the Companies' land acquisition costs, which are not entirely known but conceivably could be included in the total project costs. Thus, the City's total subsidy should fall comfortably within the safe harbor of the De Minimis Exemption with respect to the Projects.

In light of the above, the City's total financial contribution to the Companies for a relatively minimal portion of the Project costs should not convert the otherwise privately financed Projects into public works requiring the payment of prevailing wages.

II. THE CITY MUST COMPLY WITH THE NOTICING, DISCLOSURE, AND REPORTING REQUIREMENTS OF AB 562 IN CONNECTION WITH THE INCENTIVE AGREEMENTS

In October 2013, the California Legislature enacted AB 562, which added a new statutory provision – California Government Code section 53083 – effective January 1, 2014. Under AB 562, all local agencies must fulfill certain requirements in order to achieve full transparency in connection with the approval and ongoing administration of a wide spectrum of economic development subsidies. AB 562 purports to address a matter of statewide concern and thus applies to both charter cities and general law cities.[21] Cal. Gov't Code § 53083(g)(2).

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[20] Appropriate elements for inclusion in total project costs would likely encompass: (1) any new or additional real property purchase or lease costs (likely excluding costs the Companies are currently obligated to pay as well as costs unrelated to performing the Projects); (2) any costs related to permitting or development associated with new, modified, or additional facilities; (3) any alteration, demolition, installation, repair work, or maintenance work; and (4) any other new or additional related "soft costs" associated with construction of the Projects.

[21] AB 562 arguably addresses a purely municipal affair, not a matter of statewide concern. As such, a legal challenge could be mounted against AB 562 on grounds very similar to those raised in the pending litigation challenging SB 7 regarding the applicability of prevailing wages to charter cities, as discussed in Part I(E)(2) above.

AB 562 broadly defines the term "economic development subsidy" to encompass an expenditure of public funds or loss of revenue to a local agency in the amount of $100,000 or more, for the purpose of stimulating economic development (other than affordable housing projects) within the jurisdiction of a local agency, including incentives such as fee waivers, tax abatement, tax exemptions, and tax credits. Cal. Gov't Code § 53083(g)(1). Based upon this broad definition, the Incentive Agreements are plainly subject to the new AB 562 requirements, as they will involve the City's expenditure of funds or the City's loss of revenue in favor of the Companies for the purpose of stimulating local economic development.

Under AB 562, a local agency must complete two steps before approving any economic development subsidy. First, the local agency must provide certain information in written form available to the public, and must post this information on its official web site (if applicable). The relevant information includes: (i) the name and address of all entities who will receive the subsidy; (ii) the start and end dates and schedule, if applicable, for the subsidy; (iii) a description of the subsidy, including the estimated total amount of the subsidy; (iv) a statement of the public purposes for the subsidy; (v) the projected tax revenue to the local agency as a result of the subsidy; and (vi) the estimated number of jobs created by the subsidy, categorized into full-time, part-time, and temporary positions. Cal. Gov't Code § 53083(a). This information must remain available to the public and posted on the agency's web site (if applicable) during the entire term of the subsidy. *Id.* § 53083(c).

Second, the local agency must provide public notice and hold a public hearing, although these tasks may be accomplished in conjunction with any other law affecting the proposed subsidy, such as the California Environmental Quality Act. Cal. Gov't Code § 53083(b). AB 562 does not clearly prescribe the method that the local agency must employ to deliver advance notice of the public hearing and does not cross-reference any specific noticing provisions in other California statutes. *See, e.g.*, Cal. Gov. Code §§ 6060-6066, 65090. However, the statute provides: "Each public hearing required by this section shall be consolidated with a local agency's regularly scheduled hearing." *Id.* § 53083(f). This language, coupled with legislative analysis accompanying AB 562, suggests that the notice of public hearing need not be published in a newspaper of general circulation and can instead comply with the normal 72-hour noticing requirement in the Ralph M. Brown Act for a regularly scheduled meeting, so long as there is no other legal requirement for publication of the notice.[22] *Id.* § 54954.2(a).

Moreover, AB 562 imposes certain reporting obligations after the local agency approves the economic development subsidy. Within the term of each subsidy, but no later than five years after the action granting the subsidy, the local agency must provide a written report detailing several categories of information intended to reflect the actual effectiveness of the subsidy. Cal.

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[22] This Office recommends the formal opening of a public hearing and the acceptance of public testimony during the Council meeting with respect to any economic development subsidy before the Council commences its deliberations on the subsidy. Generally, this Office further recommends that City staff include the notice of public hearing in the backup agenda materials pertaining to the Council's approval of any economic development subsidy and post the notice of public hearing on the City's web site at least ten days in advance of the public hearing. In this instance, however, Charter section 99 applies to the Incentive Agreements (as discussed in the Background section above) and requires the Council to "[hold] a public hearing which has been duly noticed in the official City newspaper at least ten days in advance." Thus, this Office has advised City staff to comply with the noticing requirements in Charter section 99 with respect to the proposed approval of the Incentive Agreements. The City's use of the noticing method under Charter section 99 will satisfy the noticing requirement set forth in AB 562. *See* Cal. Gov't Code § 53083(b).

Gov't Code § 53083(d). Within the same time frame, the local agency must hold a public hearing to consider any public comments on the written report. *Id.* § 53083(e)(1). If the term of the subsidy is at least ten years, the local agency must hold another public hearing upon the conclusion of the subsidy. *Id.* § 53083(e)(2). Assuming the Council approves the Incentive Agreements, City staff will need to ensure that the City fulfills these statutory reporting obligations in connection with the Incentive Agreements.

III. THE CITY'S CURRENT INCENTIVE PROGRAM AND ITS AWARD OF THE INCENTIVE AGREEMENTS LIKELY COMPLY WITH GENERAL PRINCIPLES OF EQUAL PROTECTION

A. General Principles of Equal Protection

The Incentive Program and the City's award of the Incentive Agreements must comply with principles of equal protection. The Equal Protection Clause of the Federal and State constitutions requires that governmental decision makers treat parties equally under the law if those parties are alike in all relevant respects. U.S. Const. amend. XIV, § 1; Cal. Const. art. I, § 7; *Las Lomas Land Co., LLC v. City of L.A.*, 177 Cal. App. 4th 837, 857 (2009).

The United States Supreme Court has employed three levels of analysis to resolve issues under the Equal Protection Clause: (i) strict scrutiny for legislation that distinguishes between individuals within suspect classifications or affects fundamental rights; (ii) intermediate scrutiny for legislation that distinguishes between individuals based on gender; and (iii) rational basis review for all other legislation. *People v. Hofsheier*, 37 Cal. 4th 1185, 1199 (2006). Neither the Incentive Program nor the award of the Incentive Agreements involves inherently suspect classifications or fundamental rights, or gender-based distinctions. Instead, Council Policy 900-12 makes classifications based on economic factors associated with a business or a project.[23] The proposed award of the Incentive Agreements involves the mere implementation of this Policy. Therefore, if challenged, the Policy's classification of businesses and the City's award of the Incentive Agreements would be found to comply with general principles of equal protection so long as they satisfy rational basis review.

Under rational basis review, the classification at issue must bear a rational relationship to a legitimate State interest. *Hofsheier*, 37 Cal. 4th at 1200. The courts will presume that a classification is valid. *City of Cleburne v. Cleburne Living Center*, 473 U.S. 432, 432 (1985). However, a classification must be non-arbitrary and founded upon pertinent and real differences, as distinguished from irrelevant and artificial ones. *Walters v. City of St. Louis, Mo.*, 347 U.S. 231, 237 (1954). A classification must rest upon some ground of difference that has a fair and substantial relation to the object of legislation. *Old Dearborn Distributing Co. v. Seagram-Distillers Corp.*, 299 U.S. 183, 197 (1936). If a classification has some reasonable basis, it is not made impermissible simply because it is not made with mathematical precision or it results in

[23] Section A of Council Policy 900-12 sets forth criteria for the selection of businesses or projects eligible for financial or other assistance under the Incentive Program. To be eligible, a project must be consistent with the City's Community and Economic Development Strategy and must involve at least one of four elements: (i) production of significant revenues or jobs; (ii) promotion of stability and growth of the City's tax revenues; (iii) generation of new business and other appropriate development in older parts of San Diego; or (iv) response to the efforts of other jurisdictions to induce businesses to relocate outside of San Diego.

some inequality. *Alviso v. Sonoma Cnty. Sheriff's Dept.*, 186 Cal. App. 4th 198, 208 (2010). "Defining the class of persons subject to a regulatory requirement – much like classifying government beneficiaries – 'inevitably requires that some persons who have an almost equally strong claim to favored treatment be placed on different sides of the line, and the fact [that] the line might have been drawn differently at some points is a matter for legislative, rather than judicial, consideration.'" *FCC v. Beach Commc'ns, Inc.*, 508 U.S. 307, 315-16 (1993), citing *U.S. R.R. Ret. Bd. v. Fritz,* 449 U.S. 166, 179 (1980). A reviewing court will uphold a classification "if there is any reasonably conceivable state of facts that could provide a rational basis for the classification." *FCC,* 508 U.S. at 313. It is immaterial that the legislative body's decision to support the classification may have been politically motivated. *Warden v. State Bar of Cal.*, 21 Cal. 4th 628, 650 (1999). A successful challenge must demonstrate that the legislative body could not have reasonably believed that the classification would attain its aims. *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 463-64 (1981).

B. Applicability to the City's Incentive Program

The first issue is whether the Incentive Program, as a whole, complies with general principles of equal protection. As mentioned above, the Incentive Program establishes criteria to determine those businesses or projects that meet the classification and thus are eligible for economic incentives. The Incentive Program suggests that its classification (i.e., the selection criteria) aims to identify those businesses that advance "major revenue, job generating, and revitalization projects" and "to ensure that the Program is equitably and efficiently administered." Council Policy 900-12, p. 1. Moreover, the Policy clearly describes the Incentive Program's objectives "to offer financial or other assistance for major revenue and job generating projects that promote a sound and healthy economy, to promote the stability and growth of City taxes and other revenues, to encourage new business and other appropriate development in older parts of the City, and to respond to other jurisdictions' efforts to induce business to relocate from San Diego." *Id.* It is reasonable to conclude that the Incentive Program's selection criteria for businesses eligible to receive financial assistance bear a rational relationship toward the Incentive Program's stated goals. The Policy outlines criteria that distinguish projects based on factors directly related to local economic development, including whether a business or project will (1) provide "significant revenues and/or jobs," (2) promote "City taxes and other revenues," and (3) "[e]ncourage new . . . development in older parts of the City." *Id.* at p. 2.

The Incentive Program's classification of eligible businesses rests on pertinent and real differences between businesses and has a fair and substantial relation to the Incentive Program's purpose of promoting economic development.[24] Thus, it is unlikely that a court would find the Incentive Program, as a whole, violates the Equal Protection Clause, so long as the City administers the Incentive Program in an objectively reasonable manner.[25] In distinguishing

[24] Although the classification contained in the Incentive Program would likely withstand a challenge under general principles of equal protection, the Council may wish to consider establishing more clear criteria for selecting the businesses that will receive particular types of subsidies in order to reduce the risk of a challenge to the Incentive Program's classification of businesses and the incentives provided to those businesses. This is especially true if the City intends to use the Incentive Program more often moving forward for a variety of different types of businesses.

[25] Aside from the legal perspective, the Council should examine whether the use of the Incentive Program is sensible from a policy perspective. The City's award of the Incentive Agreements to two specific businesses, among many businesses that may be eligible throughout San Diego, could invite criticism in terms of selecting "winners" and "losers" within the beer manufacturing industry or in comparison to non-manufacturing industries. The award of the

between businesses under the Incentive Program, the Council must determine that a material difference exists between those businesses that meet the Incentive Program's selection criteria and those that do not. To be material, this difference should be related to the underlying purpose for adopting the selection criteria in the Incentive Program. Although the Council is not required to articulate its reasoning at the time of approval of any particular incentives, the record in each instance should contain sufficient information to support some rational basis for the City's selection of a specific business to receive financial assistance under the Incentive Program.

C. Applicability to the Incentive Agreements

The next issue is whether the Incentive Agreements comply with general principles of equal protection. With regard to the potential award of the Incentive Agreements, City staff has included factual support in the record to demonstrate that the Companies objectively meet the Incentive Program's selection criteria. Under general principles of equal protection, it is immaterial that the award of the Incentive Agreements might indicate favorable treatment toward a certain type of business, or to specific companies within a particular sector. The Incentive Agreements merely must be awarded based on the objective selection criteria set forth in the Incentive Program. Based on the information provided by City staff, there is nothing to suggest that: (1) the Incentive Agreements are being proposed simply because they involve craft breweries; (2) the award of the Incentive Agreements is not in compliance with the Incentive Program; or (3) the selection of the Companies under the Incentive Program is arbitrary or based on irrelevant differences between the Companies and other businesses in San Diego.

It is likely that the Companies can be distinguished from other breweries, and that beer manufacturing can be distinguished from other types of businesses, in a non-arbitrary manner. As explained in the pertinent staff reports, manufacturing is one of the four main economic engines or base sectors which generate revenue for the City, and the beer manufacturing industry has grown substantially over the past several years. Staff has projected that the Companies – and the beer manufacturing industry as a whole – will generate a high level of tax revenues and well-paying jobs in comparison to other types of businesses and industries locally.[26] As such, staff has determined that the Projects are likely to deliver significant benefits to the local economy, consistent with the stated purposes of the Incentive Program.

The Council will need to determine whether there is a rational basis in the record to support the favorable treatment of the Companies and to approve the Incentive Agreements, resulting in the Companies' receipt of financial and other assistance under the Incentive Program that may not be practically available to similarly-situated local businesses. Among the facts that a court could consider in determining whether a rational basis exists is whether these breweries –

Incentive Agreements also may lead to a "me, too" circumstance, in which many companies, including those with a long-standing successful track record in San Diego, become discouraged that they are not receiving the same type or level of incentives from the City as their direct business competitors.

[26] Staff has found that beer manufacturing of the type conducted by the Companies has a very high jobs multiplier of 5.7:1. With regard to Ballast Point, staff has estimated that the Project will create 100 additional jobs at the brewery location and 470 additional jobs in other industries and at other establishments. With regard to AleSmith, staff has estimated that the Project will create 50 additional jobs at the brewery location and 235 additional jobs in other industries and at other establishments. According to staff's projections, each Project will generate approximately $50,000 annually in net new tax revenue to the City, and the reimbursement of Development Fees to each Company will be fully paid from new net tax revenue within approximately three to four years.

as compared to other businesses – will promote the local economy in a more significant manner. To support a decision to award the Incentive Agreements, the record in front of the Council should contain ample information demonstrating how the Incentive Agreements meet the Incentive Program's selection criteria and how they are rationally related to the Incentive Program's stated purposes regarding economic development.

IV. THE PROVISION OF FINANCIAL ASSISTANCE TO THE COMPANIES PURSUANT TO THE INCENTIVE AGREEMENTS WILL NOT CONSTITUTE AN IMPERMISSIBLE GIFT OF PUBLIC FUNDS SO LONG AS THIS FINANCIAL ASSISTANCE ACHIEVES A PUBLIC PURPOSE

A. Legal Standard Regarding an Impermissible Gift of Public Funds

The California Legislature is constitutionally prohibited from the "making of any gift, of any public money or thing of value to any individual, municipal or other corporation whatever . . . ." Cal. Const. art. XVI, § 6. This constitutional provision is not applicable to charter cities. *Tevis v. City & County of S.F.*, 43 Cal. 2d 190, 197 (1954). The City, as a charter city, derives its powers from its own charter, rather than the California Legislature. *See L.A. Gas & Electric Corp. v. City of L.A.,* 188 Cal. 307 (1922). Yet, the Charter prohibits a gift of public funds in a manner similar to the constitutional provision. Charter section 93 states, in relevant part, that "[t]he credit of the City shall not be given or loaned to or in aid of any individual, association or corporation; except that suitable provision may be made for the aid and support of the poor." Cases interpreting the prohibition against a gift of public funds in the California Constitution are therefore instructive in interpreting Charter section 93.

An expenditure of public funds that benefits a private party constitutes an impermissible gift if the public agency does not receive adequate consideration in exchange or if the expenditure does not serve a public purpose. 2011 City Att'y Report 384 (11-17; Apr. 7, 2011), citing *People v. City of Long Beach,* 51 Cal. 2d 875, 881-83 (1959); *Cal. Sch. Emps. Ass'n. v. Sunnyvale Elementary Sch. Dist.,* 36 Cal. App. 3d 46, 59 (1973); and *Allen v. Hussey,* 101 Cal. App. 2d 457, 473-74 (1950). The existence of adequate consideration[27] is tantamount to the achievement of a public purpose, and the expenditure of funds for a public purpose is not constitutionally prohibited even if the expenditure incidentally benefits a private party. *Orange Cnty. Found. v. Irvine Co.,* 139 Cal. App. 3d 195, 200-201 (1983) (settlement agreement achieves no public purpose if agreement requires public agency to make payment in exchange for plaintiff's relinquishment of wholly invalid claim, but relinquishment of colorable legal claim in exchange for settlement payment constitutes adequate consideration).

B. Applicability to the Incentive Agreements

The Incentive Program is intended to encourage "major revenue, job generating, and revitalization projects or businesses" in San Diego through the City's provision of economic

[27] Consideration is "simply the conferring of a benefit upon the promisor or some other person or the suffering of a detriment by the promisee or some other person. . . . Consideration, if it consists of a benefit, must have some value." *Cal. Sch. Emps. Ass'n.,* 36 Cal. App. 3d at 59. To avoid being classified as a gift, the level of consideration given in exchange for a transfer of public funds must be sufficient to evidence a bona fide contract and cannot be merely nominal. *Winkelman v. City of Tiburon*, 32 Cal. App. 3d 834, 845 (1973).

incentives "when necessary or appropriate to attract, retain, expand, or assist projects or businesses which meet [the Policy's] . . . criteria." Council Policy 900-12, pp. 1-2. Available incentives include, but are not limited to: (1) credits or rebates of sales or use taxes paid by the business against City business license taxes or development-related fees, if such sales or use taxes constitute previously uncollectable revenue to the City; (2) reimbursements of City permit processing fees; and (3) rebates of the City's portion of real and personal property taxes paid to the County Assessor levied on real and personal property related to the project's manufacturing process after the City's receipt thereof. Council Policy 900-12, p. 2.

The Incentive Agreements envision that the Companies will be reimbursed for all fees paid to the City in connection with the Projects. The elements of the reimbursement will include: (1) 100% of the local 1% sales and use tax paid by the Companies in connection with the purchase of taxable tangible personal property placed into service at the Project sites; (2) 100% of the City's share of secured real property taxes paid annually in connection with improvements to the Project sites; and (3) 50% of the local 1% sales tax collected from Company's retail customers in connection with the sale of any products on the Project sites.[28] City staff has indicated that the City's reimbursement of fees will be paid through the expenditure of funds for the Business Cooperation Program budgeted in the Citywide Program.

City staff anticipates that the provision of economic incentives under the Incentive Agreements will contribute to each Company's decision to locate its brewery within San Diego, as opposed to other jurisdictions, which in turn will substantially increase tax revenues and local jobs for the City's benefit.[29] Thus, the City will receive consideration in exchange for the provision of economic incentives to the Companies, as described in the pertinent staff reports. It is very likely that a court would conclude the Incentive Agreements involve an exchange of adequate consideration and achieve one or more public purposes. As such, the City's award of the Incentive Agreements should not result in a prohibited gift of public funds.

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[28] Council Policy 900-12 grants the City Manager administrative discretion to authorize certain incentives subject to express limitations, but requires the Council's approval of other incentives, such as reimbursing all or a portion of City permit processing fees. The Incentive Program does not expressly require the Council's approval for those categories of incentives that the City Manager may authorize, but that exceed the dollar limitations of the City Manager's authority. For example, the Incentive Program provides that the City Manager is authorized to administratively approve a credit of up to 45% and a rebate of up to 25% of sales or use taxes paid by the business against City business license taxes or development-related fees if such sales or use taxes constitute previously uncollectable revenue to the City. Yet, the Policy does not expressly provide that the Council can approve the same type of incentive at a higher amount. Despite the Policy's silence on the Council's authority to approve incentives in excess of the dollar limitations allowed under the City Manager's authority, a reasonable interpretation of the Policy gives the Council such authority. This Office's interpretation of the Incentive Program, then, is that it allows the Council to approve the incentives set forth in the Incentive Agreements, which provide for sales and use tax incentives in excess of the amount which can be administratively approved by the City Manager.

[29] The Companies do not owe any current obligation to locate, expand, or develop a new brewery at the Project sites, situated in San Diego. The Incentive Agreements seek to incentivize the Companies to remain in San Diego and to expand their business operations for the mutual benefit of the Companies and the City. As described above, City staff estimates that if the Companies develop their breweries at the Project sites, the City will receive approximately $50,000 annually in net new tax revenues at each site which the City is unlikely to receive otherwise. Given that the Companies have not yet formally agreed to locate their proposed breweries in San Diego, the Companies are free to move their operations to other jurisdictions. Thus, sales and use taxes associated with the Projects should constitute previously uncollectable revenue to the City, consistent with the Incentive Program.

To create a legally defensible position for the City with respect to any claim that the Incentive Agreements entail an impermissible gift of public funds, this Office has advised City staff to include the facts supporting the adequacy of consideration and the achievement of public purposes in the staff report related to each Incentive Agreement. Indeed, AB 562, as discussed in Part II above, requires City staff to prepare a written summary of the public purposes for the economic development subsidies offered in the Incentive Agreements. In addition, this Office recommends that the Council make an express finding of public purpose in support of any award of the Incentive Agreements. It is likely that a court would show substantial deference to this finding so long as there is at least some factual support in the record.

V. THE CITY'S REIMBURSEMENT OF DEVELOPMENT FEES TO THE COMPANIES WILL NOT VIOLATE PROPOSITIONS 218 OR 26

As mentioned above, the Incentive Agreements require the City to reimburse the Companies for the Development Fees, consisting of FBA Fees and Permit Processing Fees, using specific credit formulas. The City plans to use General Fund monies to reimburse the Companies, but only to the extent that the Projects generate sales and use tax revenues and property tax revenues, and only after the City receives those tax revenues. The discussion below evaluates whether the City's reimbursement of the Development Fees to the Companies, but not to other development applicants as a whole, will result in a violation of Propositions 218 or 26.

A. Brief Description of Two Statewide Propositions

In November 1996, California voters passed a statewide initiative known as Proposition 218, which added articles XIII C and XIII D to the California Constitution. Article XIII C prohibits local governments from imposing or increasing any tax, general or special, without voter approval; in the case of any special tax, two-thirds of local voters must approve the measure. Cal. Const. art. XIII C, § 2. Article XIII D restricts the manner in which local governments may levy assessments upon real property and fees or charges on real property or on a person as an incident of property ownership. Cal. Const. art. XIII D, §§ 1-6. However, Proposition 218 does not "[a]ffect existing laws relating to the imposition of fees or charges as a condition of property development." Cal. Const. art. XIII D, § 1(b).

In November 2010, California voters passed another initiative known as Proposition 26, which amends provisions of articles XIII A and XIII C of the California Constitution. These amendments limit 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 agencies on or after November 3, 2010, is considered a special tax requiring approval of two-thirds of local voters unless the fee fits within an exception. Cal. Const. art. XIII C, § 1. One such exception where the fee would not be considered a tax under Proposition 26 is "a charge imposed as a condition of property development." Cal. Const. art. XIII C, § 1(e)(6).

B. Reimbursement of FBA Fees

Under the "home rule" doctrine, the City (as a charter city) is empowered to finance the cost of public improvements through assessment procedures enacted by ordinance, without regard to the provisions of State law. Cal. Const. art. XI, § 5; Charter § 2; *J.W. Jones Co. v. City*

of San Diego, 157 Cal. App. 3d 745, 756 (1984). The City will assess the FBA Fees to the Companies under the Procedural Ordinance for Financing of Public Facilities in Planned Urbanizing Areas (FBA Ordinance). SDMC §§ 61.2200-61.2216. The FBA Ordinance designates lands that will receive special benefits from the acquisition, construction, and improvement of certain public facilities, and imposes assessments on land related to the special benefits received. *Id.* § 61.2200. The FBA Fees are "paid by the Construction Permit applicant or landowner [i.e., the Companies] prior to the issuance of any Construction Permit issued or required for development that would benefit from the Public Facilities Projects."[30] *Id.* § 61.2210. The City's financing plans specify that the amount of the FBA Fees is calculated based upon the collective costs of the identified Public Facilities Projects, which are to be distributed over the undeveloped or underdeveloped parcels within the area of benefit.

The Companies are not required to pay the FBA Fees unless and until they apply for a Construction Permit, and the payment is due before issuance of a Construction Permit. The basis for payment of the FBA Fees is a development-related application, which signifies that the imposition of the charge most clearly relates to the voluntary act of development rather than a mere incident of property ownership. Given that the FBA Fees are imposed as a condition of property development, an exception from Propositions 218 and 26 will apply to the City's imposition of the FBA Fees.

The City's reimbursement of FBA Fees to the Companies could violate Propositions 218 or 26 if the reimbursement caused other development applicants to pay higher-than-normal amounts toward the collective costs of Public Facilities Projects. However, this is not how the City's reimbursement will operate. Instead, the City will collect the full amount of FBA Fees from the Companies before issuance of any Construction Permit for the Projects and will hold those FBA Fees in a separate account to be used solely for completion of Public Facilities Projects within the applicable area of benefit. The City will not waive or reduce the payment of FBA Fees. The City will utilize General Fund monies to make any reimbursement of FBA Fees to the Companies, so long as the Projects generate additional tax revenues for the City's benefit. The City's reimbursement of FBA Fees to the Companies will not cause any overall shortfall in financing for Public Facilities Projects and will not compel any other development applicants to pay increased fees in order to make up any shortfall or to subsidize the Companies' fair share of the collective costs of Public Facilities Projects. Accordingly, the City's reimbursement of FBA Fees will not violate Propositions 218 or 26.

C. Reimbursement of Permit Processing Fees

The City will collect the Permit Processing Fees, such as plan check, inspection, and other cost recovery fees, only in connection with the voluntary decision of the Companies to pursue development of the Projects. Given that the Permit Processing Fees (as with the FBA

[30] A "Construction Permit" means a permit issued pursuant to Land Development Code Chapter 12, Article 9. Construction Permits include Building Permits, Electrical Permits, Plumbing/Mechanical Permits, Demolition/Removal Permits, Grading Permits, Public Right-of-Way Permits, Fire Permits, and Sign Permits. SDMC § 61.2202. A "Public Facilities Project" means any and all public improvements, the need for which is directly or indirectly generated by development. *Id.*

Fees) are imposed as a condition of property development, an exception from Propositions 218 and 26 will apply to the City's imposition of the Permit Processing Fees.

In addition to the exception for charges imposed as a condition of property development, Proposition 26 sets forth three exceptions that relate specifically to cost recovery, as follows:

> (1) 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;
>
> (2) A charge 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;
>
> (3) A charge imposed for the reasonable regulatory 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).

In other words, the City is not permitted to charge an amount of Permit Processing Fees that is more than necessary to cover reasonable costs, and the allocation of those costs among fee payers must bear a fair or reasonable relationship to the fee payer's burdens on, or benefits received from, the City in connection with the permitting process. If the amount charged exceeds reasonable costs, or is inequitably allocated among fee payers, the Permit Processing Fees may be considered a special tax subject to Proposition 26.

The Permit Processing Fees are designed to recover the City's staffing costs for processing development applications for the Projects. Yet, as explained above, other development applicants will not be compelled to pay additional fees of this type as a result of the City's future reimbursement of the Permit Processing Fees to the Companies. The City's General Fund, not other development applicants, will subsidize the reimbursement of Permit Processing Fees to the Companies. Thus, the City's reimbursement of Permit Processing Fees to the Companies will not violate the cost recovery provisions of Proposition 26.

VI. THE CITY'S REBATE OF LOCAL SALES TAXES TO THE COMPANIES WILL NOT RESULT IN A LOSS OF SALES TAX REVENUE TO ANOTHER JURISDICTION IN VIOLATION OF STATE LAW

As part of the Incentive Program, the City may assist projects or businesses that "promote the stability and growth of City taxes and other revenues," provided that the projects or businesses are "consistent with the City's current adopted Community and Economic Development Strategy." Council Policy 900-12, pp. 1-2. One mechanism available to further the goals of the Incentive Program is to rebate the sales and use taxes paid by a business. *Id.*

The Incentive Agreements require the City to rebate a portion of the City's share of the sales and use taxes generated by the Projects. The Bradley-Burns Uniform Local Sales and Use Tax Law (Bradley-Burns Act) governs the payment of sales and use taxes. The Bradley-Burns Act allows counties to raise revenue by imposing a sales tax of up to 1.25 percent on retail sales of "all tangible personal property" sold in the county and a use tax of up to 1.25 percent on "tangible personal property purchased from any retailer for storage, use or other consumption in the county." Cal. Rev. & Tax. Code §§ 7202-7203. Sales tax is distributed based on the location of the retailer's place of business where the retail sales have been consummated. *Id*. § 7205.

Generally, a local public agency is prohibited from luring a business away from another local agency by offering certain financial incentives, such as local sales tax rebates, to the business. Cal. Gov't Code §§ 53084, 53084.5. A local agency also is prohibited from making *any* type of contract involving the transfer of any amount of local sales tax proceeds if the contract results in a loss of revenue by another local agency, where the retailer continues to maintain a physical presence within that other local agency's jurisdiction. *Id*. § 53084.5.

The determining factor in allocating sales tax revenue is where the business transaction occurs. Ballast Point currently conducts its business in the Scripps Ranch, Little Italy, and Linda Vista areas of San Diego, and AleSmith currently conducts its business in the Mira Mesa area of San Diego. Given that each Company is situated within San Diego, and neither Company is currently generating sales and use tax revenues for other California jurisdictions, the City could not cause existing sales and use tax revenues to be re-directed from other California jurisdictions to the City by awarding the Incentive Agreements to the Companies. Therefore, the City's award of the Incentive Agreements will not violate California law relating to local sales tax rebates.

CONCLUSION

The City's potential reimbursement of Development Fees to the Companies will not trigger a requirement for the Companies to comply with the City's competitive contracting procedures, the Equal Employment Opportunity Program, the Nondiscrimination in Contracting rules, the Equal Benefits Ordinance, or the Living Wage Ordinance. The Companies also will not be subject to prevailing wage requirements because, even though the Projects likely constitute public works as defined in State prevailing wage laws, the amount of the public subsidies in comparison to overall project costs will fit within the De Minimis Exemption.

The City must comply with the noticing, disclosure and reporting requirements in AB 562 because the Incentive Agreements involve the City's award of economic development subsidies that fall within the purview of AB 562.

The Incentive Program likely complies with general principles of equal protection because it does not involve inherently suspect classifications or fundamental rights and sets forth objective eligibility criteria that are rationally related to the Incentive Program's stated goals. Similarly, the City's selection of the Companies for the award of incentives in accordance with the objective eligibility criteria in the Incentive Program likely complies with general principles of equal protection.

The City's potential reimbursement of Development Fees to the Companies will not constitute an illegal gift of public funds so long as the Incentive Agreements involve an exchange of adequate consideration and achieve one or more public purposes. The pertinent staff reports describe the exchange of consideration and the public purposes associated with the Incentive Agreements. To bolster the record, the Council will be asked to adopt a finding of public purpose in connection with the Incentive Agreements.

The City's reimbursement of Development Fees to the Companies under the Incentive Agreements will not violate Propositions 218 or 26 because the City's reimbursement will be derived from the City's General Fund and will not cause other development applicants to pay increased amounts of fees to the City.

Finally, the City's rebate of local sales taxes to the Companies will not result in a loss of sales tax revenue to another jurisdiction in violation of the State law that prohibits one local public agency from luring a business away from another local agency by offering certain tax-based financial incentives. The Companies presently operate their breweries in San Diego, such that the rebate of sales taxes to the Companies will not lure them away from another jurisdiction.

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