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Prop. 26: New Supermajority Requirements for Regulatory Fees

by

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A statewide initiative on the November 2010 ballot is the latest threat to local control in government finance and might further complicate State budget negotiations. Proposition 26 would recategorize a swath of state and local fees as taxes, imposing supermajority approval hurdles for what are now regulatory and impact fees that can be adopted by simple majorities of the State Legislature, city councils, and county boards of supervisors. This paper summarizes the measure, the campaign arguments for and against it and identifies what we know and what remains open to question about its impact on California's local governments.

Background. In 1997 the California Supreme Court ruled in *Sinclair Paint Co. v State Board of Equalization*,² that a fee imposed on businesses that made products containing lead to fund health services to children and to otherwise mitigate the social and environmental consequences of lead contamination. The challengers argued unsuccessfully that the measure should have been imposed as a tax with $\frac{2}{3}$ approval of each chamber of the Legislature under Proposition 13 rather than as a majority-vote regulatory fee. The Court ruled that the use of the proceeds of a fee need not benefit those charged to avoid characterization as a tax as long as the fee bears a reasonable relationship to the burden imposed by those charged. Fees of this kind are called "regulatory fees." In recent years, California courts have upheld such fees imposed to regulate point-source emitters of air pollution³ and an air quality district's fee on new development to mitigate the impacts of that development on air quality.⁴ Fees have been proposed to mitigate the adverse social or environmental consequences of other products and economic activities, too, such as fees on sweetened beverages to fund anti-obesity programs, fees on alcohol

¹ The author acknowledges the contributions of Michael Coleman of CaliforniaCityFinance.com to an earlier version of this paper. The views stated here and any errors are, of course, the author's alone.

² 15 Cal.4th 866.

³ *San Diego Gas & Elec. Co. v. San Diego County Air Pollution Control District*, 203 Cal.App.3d 1132 (1988) (air pollution permit fees based on volume of pollutants emitted by permittee rather than cost of staff time devoted to issuance of permit).

⁴ *California Building Industry Ass'n v. San Joaquin Valley Air Pollution Control District*, 178 Cal.App.4th 120 (2009) (indirect source rule did not impose a fee regulated by A.B. 1600 or exceed district's authority, but was valid regulatory fee under *Sinclair Paint*).

vendors to fund police services and public education efforts to address the adverse consequences of alcohol consumption.⁵

In addition, the state budget struggles of recent years led to a number of proposals in the State Legislature to avoid the need for two-thirds approval of new revenues, such as a proposed surcharge on vehicle license fees (VLF) to fund state parks,⁶ and a December 2008 proposal to reduce state taxes on gasoline, but to increase fees on gasoline to fund public transportation and other programs.

The Measure. Proposition 26 would recategorize as taxes many regulatory fees that benefit the public broadly rather than providing a direct and distinct benefit to the business owner or other fee payor. Among these are regulatory fees and assessments to address the health, environmental and other social effects of business activities.

| Approval Requirements: State & Local Fees & Taxes <i>Proposition 26 would recategorize many fees as taxes</i> | | |
|--|---|--|
| | Fee | Tax |
| State | Majority of each house of the Legislature and Governor's approval | For measures increasing state revenues,* 2/3 of each house of the Legislature and Governor's approval or initiative constitutional amendment approved by simple majority of voters |
| City or County | Majority of the city council or board of supervisors | 2/3 voter approval for a special tax, majority voter approval for a general tax |
| <i>*Proposition 26 would require a 2/3 vote for any law that increase the taxes of any taxpayer, regardless of its overall effect on state revenues.</i> | | |

The measure also broadens the 2/3 legislative vote requirement for increases in any state tax. The California Constitution currently requires 2/3 approval of each house of the Legislature for laws enacted “for the purpose of increasing revenues.” Proposition 26 substantially expands this supermajority requirement by requiring 2/3 approval of each house of the legislature for any law that will increase the taxes of any taxpayer, regardless of its overall effect on state revenues.⁷ This is comparable to the requirements of Proposition 218 for local government taxes.⁸

Proposition 26 would require any state fee approved in 2010 that violates its terms to expire by late 2011 unless re-enacted in compliance with the new 2/3-vote requirement. No similar “window period” is established for local governments fees and, if approved by California’s voters, the measure will be effective as to local governments only from November 3, 2010.

⁵ *City of Oakland v. Superior Court*, 45 Cal. App. 4th 740 (1996) (pre-*Sinclair Paint* case upholding fee on liquor stores to fund city services made necessary by alcohol consumption).

⁶ This proposal appears on the November 2, 2010 ballot as Proposition 21, but will be voided by Prop. 26 unless Prop. 26 is defeated or Prop. 21 obtains more “yes” votes than Prop. 26.

⁷ Proposed California Constitution, Art. XIII A, § 3(a).

⁸ *Cf.* Government Code § 53750(h) (defining tax “increase” for purposes of Prop. 218).

Fees Proponents Say Proposition 26 will Address

- Health inspection / monitoring fees
- Public safety cost mitigation fees
- Traffic, parking, noise abatement, and air quality impact fees for education, cleanup, health or other programs of general benefit
- Water quality impact fees for education, cleanup, health or other programs of general benefit
- Solid waste, tires, canned beverages, food packaging, computer hardware and toxic waste disposal fees used for education, cleanup, recycling / reuse, health or other programs of general benefit
- Alternative energy fees and energy use surcharges
- Fees on alcohol to litigate public nuisances associated with sale or consumption
- Fees on soda, unhealthy foods, fats, or sugar to mitigate obesity and other negative health effects
- Trenching fees for diminution in durability or longevity of roads, traffic congestion mitigation, mitigate potential damage to existing infrastructure
- Environmental mitigation and eco-impairment fees including carbon consumption fees, oil severance fees, and hazardous waste fees to support programs of general public benefit
- Vehicle registration or gasoline fees for transportation programs or environmental cleanup of general benefit
- Fees on tobacco for mitigating the adverse health effects of tobacco products (including evaluation, screening, and necessary follow-up services to those deemed potential victims of tobacco-related injuries) or to discourage consumption (by increasing cost of product) and/or to educate the general public on the consequences of tobacco consumption. Fees to prevent illegal consumption by minors
- Fees on wireless telecommunications to reduce the impacts of DWTs (Driving While Talking), burdens on the 911 system, potential future effects of close proximity radio frequency exposure
- Fees on “altered food” products (chemical, gene, hormone, etc.) for research, screening, testing and treatment or education.

- Fees on television and movie programming to mitigate effects of violence on youth or similar anti-social consequences linked to programming
- Fees on gambling activities to treat compulsive gambling including screening, education, and treatment
- Fees on pharmaceuticals to treat subsequently discovered health risks associated with a particular drug product, for drug education, health research, treatment, emergency care, covering the costs of the uninsured or underinsured or for immunizations for children
- Fees on 4-wheel drive and all-terrain vehicles to offset eco-damage of off-road automobile use
- Fees on pesticides and other chemicals fees to treat the adverse health effects, for chemical use or alternative product education, research, treatment, or emergency response, cleanup or care.
- Fees on property casualty insurers for firefighting, earthquake and flood, uninsured drivers and auto case court costs.⁹

A state fee deemed a tax under Prop. 26 would require the approval of 2/3 of each house of the Legislature and the Governor.¹⁰ A local fee made a tax by Prop. 26 would be a special tax (because it would be used for a specific purpose) and would require 2/3 voter approval unless restructured to fund general government services.¹¹

The ballot arguments regarding Proposition 26 also identify a number of fees which may be affected by the measure such as oil spill mitigation fees, hazardous waste clean-up fees, fees on tobacco products to fund health programs, fees on alcohol to fund police services and efforts to prevent youth drinking and road impact fees.¹²

Exceptions to the Definition of “Tax.” Proposition 26 excludes from its new definition of “tax” the following kinds of fees:

- for a benefit of privilege conveyed (like a professional license or a land use approval)
- for a service or product (like a park and recreation fee)
- to cover certain costs of regulation

⁹ This listing is taken from “Specific Industry Examples” an undated flyer produced by Stop Hidden Taxes, the campaign organization supporting Proposition 26.

¹⁰ Proposed California Constitution, Art. XIII A, § 3(a).

¹¹ *Id.*, Art. XIII C, § 1(e) (defining “tax”) and existing California Constitution, Art. XIII C, § 2(d) (requiring 2/3 voter approval for special taxes).

¹² The ballot arguments are available on the Secretary of State’s website at www.sos.ca.gov/elections/ballot-measures/qualified-ballot-measures.htm.

- entrance fees for state or local property (but not vehicle license fee surcharges like that proposed by Proposition 21 on the November 2, 2010 ballot) and such entrance fees are not limited to cost
- fines imposed by a court or a local government
- development impact fees imposed by a local government
- assessments and property related fees governed by Proposition 218.

Burden of Proof. Proposition 26 states that governments must bear the burden to prove by a preponderance of evidence that challenged revenue measures are not taxes; that the amount of a fee reflects the reasonable cost of providing the permit, privilege, or regulatory program for which it is imposed; and that it is allocated among fee payors so as to “bear a fair or reasonable relation to the payor’s burdens on, or benefits received from, the governmental activity.”¹³ Much of this reflects the requirements of existing law and this language might actually be helpful in giving meaning to the burden of proof rule of Proposition 218, which also makes government bear the burden to defend fees and assessments, but does not specify that the preponderance of evidence standard – the lowest of the standards applied by our courts – controls.¹⁴

Open Questions. There are a number of unknowns about the measure that seem certain to generate litigation. These include:

What does it mean that a fee must be proportionate to the benefit from or burden on a service or program with respect to which a fee is imposed? Would a fee for gas service, for example, depend on whether the person using the gas used it to warm a hospital (large benefit from the service) or run a gas grill (smaller benefit)? Probably not, but we do not know what this phrase means.¹⁵

The measure requires that fees for permits, privileges and services be imposed only when that permit, privilege or service is not provided to those not charged.¹⁶ Does this mean an end to free and discounted passes and fees for low-income households and seniors?

How much of the traditional cost of a regulatory program is now permitted to be covered by regulatory fees is now in question, especially as to rule-making by regulators – such as the advance planning services of local planning agencies.¹⁷

¹³ Proposed California Constitution, Art. XIII A, § 3(d); Art. XIII C, § 1(e) (trailing paragraph).

¹⁴ California Constitution, Art. XIII d, § 4(f) (burden of proof in assessment disputes); § 6(b)(5) (burden of proof in disputes regarding property related fees).

¹⁵ *Id.*

¹⁶ Proposed California Constitution, Art. XIII A, § 3(b)(1) & (2); Art. XIII D, § 1(e)(1) & (2).

¹⁷ The measure allows State regulatory fees to recover only “the reasonable regulatory costs to the State incident to issuing licenses and permits, performing investigations, inspections, and audits, enforcing agricultural marketing orders, and the administrative enforcement and adjudication thereof.” Proposed California Constitution, Art. XIII A, § 3(b)(3). Similar, but not identical, language is provided for local fees. *Id.*, Art. XIII C, § 1(e)(3) (“incident to” is changed to “for”).

There are minor language differences between the exemptions from the definition of “taxes” imposed by the state government as compared to those imposed by local governments. The meaning of these small differences (such as costs “incident to” issuing a permit instead of “for” issuing a permit)¹⁸ will require judicial clarification.

Proposition 218 exempted local government fees for gas and electric service from its requirements.¹⁹ Proposition 26 does not include any similar exemption and it therefore appears that such fees will now have to fall within the exemption from the definition of tax for

“[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.”²⁰

Thus, if Proposition 26 is approved, local gas and electric utilities would have a cost-of-service limit on fees that their for-profit competitors do not.

Like Proposition 218, Proposition 26 uses the word “impose” in a crucial way – it defines as a tax “any levy, charge, or exaction of any kind **imposed** by a local government” except as provided by the measure’s exceptions.²¹ We have no definition of this term, but we do know from a case involving Proposition 62, a 1987 statutory initiative involving local taxes, that it does not refer to mere continued collection of an existing revenue measure.²²

Major Impacts. There will be some significant impacts if Proposition 26 is approved by the voters. First, and most obviously, **regulatory fees** to mitigate the social and other consequences of economic activity such as those upheld in *Sinclair Paint* and its progeny will now be defined as taxes requiring $\frac{2}{3}$ voter or legislative approval. Second, **franchise fees** may now be defensible only to the extent they are a charge for the use of government property – and this might require the government have the power to exclude users from the property if the fee is not paid. This might affect fees on pipeline franchises, cable television franchises, solid waste collection franchises, etc. California Department of **Fish & Game fees** for the cost to review documents prepared by local governments under the California Environmental Quality Act (CEQA) might no longer be permissible. Finally, as noted above, **low-income and senior discounts** for various fees and charges might not longer be permitted.

Conclusion. The League of California Cities has taken an “oppose” position on Proposition 26 and other local government organizations, public health and environmental groups can be expected to do so as well. Business interests are supporting the measure. More information about Proposition 26 can be

¹⁸ Compare proposed California Constitution Art. XIII A, § 3(b)(1) & (2) with Art. XIII C, § 1(e)(1) & (2) (“to the payor” deleted from the latter); and proposed California Constitution Art. XIII A, § (3)(b)(3) with Art. XIII C, § 1(e)(3) (“incident to” vs. “for”).

¹⁹ California Constitution, Art. XIII D, § 3(b).

²⁰ Proposed California Constitution, Art. XIII C, § 1(e)(2).

²¹ Proposed California Constitution, Art. XIII C, § 1(e).

²² *McBrearty v. City of Brawley*, 59 Cal.App.4th 1441 (1997) (continued collection of tax is not “imposition” of tax requiring voter approval under Prop. 62).

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found on the Secretary of State's website (<http://www.sos.ca.gov/elections/ballot-measures/qualified-ballot-measures.htm>) and on the sites of the "yes" and "no" campaigns: no25yes26.com ("yes" campaign) and www.stoppolluterprotection.com ("no" campaign).

Plainly, there is much of interest to local government on the November 2, 2010 ballot!