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MEMORANDUM OF LAW

DATE: January 10, 1997

TO: Honorable Mayor and Members of the City Council

FROM: City Attorney

SUBJECT: Application of Proposition 218 to the City's Business Improvement Districts

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INTRODUCTION

At the Council hearing of December 10, 1996, two new Business Improvement Districts (hereafter "BIDs"), one in Pacific Beach and one in Little Italy, were submitted to the Council for approval. During that hearing, the San Diego County Taxpayers Association asserted that these BIDs were subject to Proposition 218 and could not be approved without complying with the requisites of that initiative. This office rendered an oral, preliminary opinion that, based on recent case law, the BIDs in question were not subject to Proposition 218. You asked for a further analysis and written opinion.

In responding to your request, we have kept in mind that the intent of the electorate in passing an initiative proposition is very important to consider in interpreting and implementing its provisions, particularly where provisions are unclear and may be interpreted in different ways. However, an apparent "intent" alone will not provide what is not provided for in the body of the law itself. Our opinion is therefore not based solely on what the drafters' intent might have been, but also what is legally supportable given existing case law and the terms in the proposition itself. The City Attorney's office has taken, and will continue to take, a careful look at each individual situation that may implicate Proposition 218, and will make its recommendations on a case-by-case basis with both the intent of the electorate and the reasonable legal interpretation and construction of the law's provisions in mind.

You should also be aware that we discussed this issue with representatives from the San Diego County Taxpayers' Association, the Howard Jarvis Taxpayers' Association, the League of

California Cities and the State Legislative Analyst's Office. Their opinions and reasoning have been taken into account in forming the opinions expressed herein, and where relevant to explaining our position they have been recounted below.

QUESTION PRESENTED

Are the City's BIDs, including but not limited to the Pacific Beach and Little Italy BIDs, subject to the substantive and procedural requirements of Proposition 218?

SHORT ANSWER

It is our opinion that the City's BIDs are neither "property-related assessments" nor "special taxes," and as such fall outside the scope of Proposition 218.

ANALYSIS

1. The Scope of Proposition 218

Proposition 218, the "Right to Vote on Taxes Act," is aimed at increasing "voter and taxpayer control over local taxes." (A copy of the text of Proposition 218, with annotations by the proponents of the initiative, is attached for your reference as Attachment 1). The three main focal points of this initiative are: a) general and special taxes, b) property-related fees, and c) property-related assessments. New Article XIIIC of the California Constitution addresses general and special taxes, while new Article XIIID addresses property-related fees and assessments. Fees and assessments that are not "property-related" are not affected by this measure.

The City of San Diego, like most of the municipalities in this State, has a wide variety of taxes, fees and assessments that may or may not be impacted by Proposition 218. This memorandum addresses itself only to the issue of whether the City's BIDs fall within one of the above-referenced categories, thereby requiring compliance with the substantive and procedural elements of the proposition.

In rendering this opinion, we note that many of the provisions of Proposition 218 are unclear as to scope or purpose, and it will likely take several months of actual experience with the measure's provisions (including likely litigation) to ascertain the true breadth of the measure's reach. This and other opinions on Proposition 218 are thus somewhat preliminary, but are based on our evaluation of the most reasonable, legal and practical application of the provisions.

2. The Structure of the City's BIDs

The City's BIDs, including the Pacific Beach and Little Italy BIDs, are currently formed pursuant to the Parking and Business Improvement Area Act of 1989 (hereafter the "1989 Act"), Streets & Highways Code section 36500 et seq., and our own Council Policy 900-07, adopted under the authority of the 1989 Act. (Council Policy 900-07 is attached to this memorandum as Attachment 2). The BID membership is based upon business ownership, and a vote for a BID is weighted by the assessed value of the business. Residences, and businesses holding a Home Occupancy Permit, may be exempted from membership in the BID. See, Council Policy 900-07. BIDs may have one or more zones, which are used to measure the extent of benefit received by the businesses to be assessed. Sts. & Hwys Code section 36528.

Procedurally, notice of the public hearing on the formation of a BID is mailed to all business owners in the BID, and votes of all interested persons may be counted in the vote; identification of someone as an "interested person" depends on their ownership of a business in the proposed district area. Sts. & Hwys. Code section 36524; Council Policy 900-07. The nature and amount of the assessment is based upon the benefit to the business (see, e.g., Sts. & Hwys Code section 36527(i), which provides that "in an area formed to promote tourism, only businesses that benefit from tourist visits may be assessed"). Under the 1989 Act and our Council Policy, the threshold criteria for liability for an assessment is the fact that one operates a business within the proposed district. The nature and location of the business is important to determining how much each business will be assessed, but it becomes relevant only after the liability for the assessment is established.

BIDs formed under the 1989 Act may be contrasted with those formed under the Property and Business Improvement District Law of 1994, Sts. & Hwys. Code section 36600 et seq. (The "1994 Law"). The 1994 Law was passed as a supplement to the 1989 Act (Sts. & Hwys. Code section 36602) and was based on the Legislature's finding that "[I]t is of particular local benefit to allow cities to fund property related improvements, maintenance, and activities through the levy of assessments upon the real property that benefits from those improvements.[1]" Intended as an alternative method for financing improvements in a business area, Sts. & Hwys. Code section 36617, the liability for an assessment under the 1994 Law is the ownership of an interest in real property situated in the proposed district. Sts. & Hwys. Code section 36620 et seq.

The distinction between the two acts is thus simply distilled: under the 1989 Act, one is liable to pay an assessment within a BID if one operates a business within the District, and the

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[1]Contrast this with the similar finding underlying the 1989 Act: "...it is of particular local benefit to allow cities to fund property related improvements and activities through the levy of assessments upon the *businesses* which benefit from those improvements and activities." Sts. & Hwys. Code section 36501(c).

nature of one's property ownership interest is irrelevant. Under the 1994 Law, liability for the assessment is premised upon one's property ownership; the existence or absence of a business license is irrelevant to this determination.

The Ordinance establishing the Pacific Beach BID (Attachment 3) identifies itself on its face as a BID established under the 1989 Act, consistent with the Council Policy based on the 1989 Act. It establishes two separate zones, eight categories of businesses, and provides that "all businesses operating in the above-described area will be assessed a share of the costs...according to the type of business and the benefit to be received." Each business in the district will pay anywhere from $60 to $360, depending upon their zone and category.

3. The City's BIDs Are Not "Property-Related Assessments"

New Article XIIID, section 2 of the California Constitution provides the definitions to be used in applying the provisions of Proposition 218 regarding assessments. At section 2(b), "assessments" falling within the parameters of Proposition 218 are defined as ". . . any levy or charge upon real property by an agency for a special benefit conferred upon the real property."

This definition alone should be sufficient to illustrate that BIDs formed under the 1989 Act are not within the scope of Proposition 218. Simply put, and in sharp contrast to BIDs formed under the 1994 Law, assessments levied pursuant to the 1989 Act are not "charges upon real property." Ownership interests in real property are completely irrelevant to determining a person's liability for such assessments. Thus by the most basic definition in this section of Proposition 218, it is clear that 1989 Act BIDs are not, and were not intended to be, covered.

Other provisions in this section of Proposition 218 confirm that this conclusion is legally sound. Section 3(a) of new Article XIIID defines the scope of its coverage as such: "No tax, assessment, fee or charge shall be assessed by any agency upon any parcel of property or upon any person as an incident of property ownership . . ." (emphasis added). Consistent with the basic definition of "assessment," this provision identifies the connection between the assessment and one's real property interests as the trigger for application of the restrictions of this section. 1989 Act BIDs are neither assessed "upon any parcel of property" nor "as an incident of property ownership," and as such do not logically fit within these provisions.

The San Diego County Taxpayers' Association has suggested that the definition of "property ownership" could be broad enough to encompass tenants paying fees under a 1989 Act BID. Their reasoning is basically as follows: the definition of "property ownership" includes "tenancies of real property ownership where tenants are directly liable to pay the assessment . . . in question." New Article XIIID, section 2(g). They posit that tenants who operate businesses within a BID are so invested in their rented locations that they cannot easily re-locate outside the

BID. Thus they are effectively paying the BID assessment as "an incident" of their tenancy, and should fall within the group of persons covered by this section.

This reading of the definition of "property ownership" is, in our opinion, overbroad and inconsistent with both the letter and the stated intent of the drafters of Proposition 218. First, the definition of "property ownership" necessarily and expressly incorporates the term "assessment," which as stated above is expressly defined as a charge upon real property. Because a 1989 Act BID assessment is not "a charge upon real property" (that is, the assessment is not levied against or on the basis of anyone's real property interest), it is not logically one of the liabilities contemplated in the subsequent definition of the term "property ownership."

Second, the drafters state that whether or not a tenant qualifies as having a "property ownership" interest covered by Proposition 218 "depend[s] on the terms of the lease." Plainly, they are describing the situation where a property owner who is liable to pay an assessment passes that liability on to his or her tenant, incorporating that "pass-through" into the lease terms. Indeed, they use the term "direct pass-throughs" to further explain their intent, stating that they are "more common in commercial leases . . ." Attachment 1, page 5. A tenant's lease in a commercial area will not reference 1989 Act BID assessments, however, because such assessments have nothing to do with the relationship between the landlord and the tenant. The landlord is not liable for the payment of the BID assessment[2], and the tenant business owner is not liable by virtue of his or her tenancy interest. Thus, even reference to the drafters' own stated intent shows that the Taxpayers' Association's position is not what was intended.

In speaking to the Legislative Analyst's Office (the "LAO"), we asked for the basis for their apparent position that BIDs are covered by Proposition 218. First conceding that there is a distinction between 1994 Law BIDs (which are plainly covered by Proposition 218) and 1989 Act BIDs, the attorney in the LAO stated simply that the argument advanced by the Taxpayers' Association (essentially, one based on economic compulsion) could, in her opinion, be adopted by some courts. She admitted this would involve a broad reading of the definition and that, in her opinion, the position of our office was equally sound. When asked whether the LAO would take a public position supporting or endorsing the Taxpayers' Association's interpretation, she responded "no."[3]

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[2]At least, not because of his or her property ownership. He or she may be liable if they are operating a business in the district; that liability, however, would arise because of their business operation and not as a result of, or in any way in connection with, their property ownership.

[3]She further acknowledged that there are situations in which the LAO is taking a public stance on the applicability of Proposition 218. In the area of 1989 Act BIDs, however, she said they would not.

We are of the opinion that, given the pervasive reference in Proposition 218, to "property-based" fees and assessments, as well as the explicit definition of "assessments" and follow-up references to "property ownership," the scope of Proposition 218's coverage does not logically extend to assessments that are not levied because of a person's interest in real property. Economic compulsion alone, without the additional element of property-related liability, is not anywhere contemplated by Proposition 218 and cannot rationally be read into its provisions.

4. The City's BIDs Are Not "Special Taxes" Under California Law

California law recognizes a distinction between "special taxes" and "special assessments." As recently as 1992, the California Supreme Court explained the difference between the two forms of levy:

> A special assessment is a "compulsory charge" placed by the state upon real property within a pre-determined district, made under express legislative authority for defraying in whole or in part the expense of a permanent public improvement therein . . . ." [Citations] In this regard, a special assessment is "levied against real property particularly and directly benefitted by a local improvement in order to pay the cost of that improvement" . . . "The rationale of special assessment is that the assessed property has received a special benefit over and above that received by the general public."
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> A tax, on the other hand, is very different. Unlike a special assessment, a tax can be levied "without reference to peculiar benefits to particular individuals or property." [Citations]. Indeed, "nothing is more familiar in taxation than the imposition of a tax upon a class or upon individuals who enjoy no direct benefit from its expenditure, and who are not responsible for the condition to be remedied.
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> . . .
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> Therefore, while a special assessment may, like a special tax, be viewed in a sense as having been levied for a specific purpose, a critical distinction between the two public financing mechanisms is that a special assessment must confer a special benefit upon the property assessed beyond that conferred generally.

Knox v. Orland, 4 Cal. 4th 132, 142 (1992), citing San Marcos Water District v. San Marcos Unified School District, 42 Cal. 3d 154 (1986); Solvang Municipal Improvement Dist. V. Board of Supervisors, 112 Cal. App. 3d 545 (1980); County of Fresno v. Malmstrom, 94 Cal. App. 3d 974 (1979).

Nothing in Proposition 218 changes this distinction. On the contrary, the proposition acknowledges that this distinction still exists, by according separate treatment for "special taxes" and "special assessments," and further by including in the definition of "assessment" the element of "special benefit" described in Knox. Further, the only way in which Proposition 218 alters the definition of "special tax" is that it now extends to tax revenues that are collected for specific purposes but deposited into the general fund. New Article XIIIC, section 1(d); see Attachment 1, page 2. This change does not convert a special assessment into a special tax.

In Evans v. City of San Jose, 3 Cal. App. 4th 728 (1992), the Court of Appeal used this same well-recognized distinction, to find that a BID assessment levied pursuant to the 1989 Act was not a "special tax."

> The assessment on businesses for downtown promotion is not a true special assessment. It is neither a charge on real property nor is its purpose to pay for permanent public improvements specifically benefitting the assessed real property. However, the fact that it is not a true special assessment does not necessarily mean it is a special tax . . .

Relying on the fact that the BID accorded a special benefit to a "discrete group" who are thus liable for the assessment, the court ruled that the BID assessment in that case was not a special tax. 3 Cal. App. 4th at 738, 739.

We contacted the League of California Cities to ascertain whether it has yet taken a position on this issue. In materials they are releasing next week at a Proposition 218 seminar, the League will be taking the position, based on the findings in the Evans case (that a 1989 Act BID assessment is "neither a charge upon real property" nor a special tax), that 1989 Act BIDs are not within the scope of Proposition 218.[4] We spoke with the author of this section of the materials, who confirmed that the reasoning for this conclusion is consistent with the reasoning we have set forth in this memorandum. The assessments to be levied in Pacific Beach and Little Italy pursuant to the City's 1989 Act BIDs are determined by reference to the special benefit conferred upon each business owner to be assessed. As set forth above, the Ordinance defines two zones and eight categories to be used in calculating each individual business owner's particular liability. This is a special assessment under California law, and not a special tax.

The Howard Jarvis Taxpayers' Association ("HJTA") opined, in a letter to Mayor Golding dated December 4, 1996, that the passage of Proposition 218 somehow converted the City's "tenant-based" BID special assessments into special taxes. This letter misunderstands the nature

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[4]They also rely upon the distinction between 1989 Act BIDs assessed on the basis of business licenses, and 1994 law BIDs based on property ownership.

of our BIDs, inasmuch as they are not "tenant-based" but are grounded in the possession of a business license that is not related at all to any property ownership. Moreover, as set forth above this position is contrary to the language of the proposition itself and well-established principles of law, including those in the Knox v. Orland and Evans v. City of San Jose cases.

Jonathan Coupal, Director of Legal Affairs for HJTA, explained to us the basis for his conclusion that 1989 Act BIDs are "special taxes." In his view, all property-related assessments are covered by the assessment section of Proposition 218; all assessments that are not property-based are now to be considered "special taxes." He believes that Proposition 218 thus overrules the holdings in Knox and Evans.

His conclusion in this regard is totally unsupported by the language of the Proposition itself. When defining "special tax," the Proposition goes no farther than to provide that "special taxes" retain that characteristic even if they are deposited into a general fund; there is no mention in the definition that the term "special taxes" now (without any rational basis therefor) includes non-property-related assessments. Likewise, while defining "assessments" covered by Proposition 218 as being limited to those that are real property-based, there is no mention that non-property-based assessments are now to be considered "special taxes." Nothing anywhere in the Proposition disturbs the distinction in Knox and Evans, between special assessments and special taxes, and nothing supports the notion that Proposition 218 should be read in such a sweeping manner.[5] We have discussed this issue with the League of California Cities, which advised us that they, too, reject HJTA's arguments and agree with our conclusion that 1989 Act BIDs are not covered by Proposition 218, either as property-related special assessments or otherwise as special taxes.

Mr. Coupal advised us that his office has been asked to review the instant situation closely, and that action by the City Council to confirm the Pacific Beach and Little Italy BIDs without conforming to Proposition 218 may very well result in a lawsuit. While we appreciate the advance notice of this possibility, it does not change our legal analysis, nor our opinion that any such lawsuit would be resolved in a manner consistent with our opinion.

Attempting to conform the BIDs to the provisions of Proposition 218 may result in a lawsuit in any event. First, there is the possibility of a legal challenge by the persons who formed the BID, based on the cost and expense of an election process that, they would argue, is not required by law. Second, the City would have to modify the assessment approval process in Proposition 218 insofar as it calls for an election in which "parcel owners" take part. This is unworkable with a 1989 Act BID because parcel ownership is completely irrelevant to liability for

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[5]It is also worth noting that in HJTA's annotations to Proposition 218, they identify several California cases that they believe are implicated by the Proposition. Neither Knox nor Evans are mentioned anywhere.

assessments thereunder. The Council would either have to change the Proposition's requirements from parcel ownership to business license ownership (which could be considered a violation of Proposition 218 and thus engender a lawsuit) or allow parcel owners to vote on an assessment they would not be liable for, allowing one set of persons (property owners) to impose an assessment on another set of persons (business license holders), and again possibly engendering a lawsuit. Third, even if the City successfully conformed the BID vote process to the requisites of Proposition 218's assessment procedures, a lawsuit by HJTA is likely because they consider the BID assessment to be a tax, not an assessment. Avoiding a lawsuit by HJTA appears possible only by conceding their argument that the assessments are a "special tax," and by submitting the Pacific Beach and Little Italy BID assessments to a vote of the entire electorate of the City, whereupon a 2/3 majority would be required to approve these districts. Given the League of California Cities' conclusion that 1989 Act BID assessments are not a special tax, a lawsuit might then be brought by other interested parties, seeking a court ruling that the League's position is correct.

CONCLUSION

Bearing in mind the principle that ambiguities in Proposition 218 should be resolved in favor of a liberal application of the proposition, we nevertheless cannot reach a conclusion that is not supported by the anything in the proposition itself. We do not believe the provisions of Proposition 218 are ambiguous with respect to the property-based nature of the assessments to be covered by its provisions. Nor is there any suggestion that the Proposition has the effect of broadening the definition of "special tax" to incorporate assessments that are outside the scope of the proposition's assessment provisions. Had they intended this broad sweep, they could easily have so provided in the course of crafting their definition of "special tax," but they did not. Thus there is not, in our opinion, an "ambiguity" to be resolved in this situation.

Based on the terms used in the relevant provisions of the proposition, and existing case law available to interpret those terms, we are of the opinion that the correct legal conclusion is that 1989 Act BIDs are neither property-related assessments nor special taxes, even under the provisions of Proposition 218, and as such do not fall within its scope. We must advise, however, that this area of the law is new and, notwithstanding our belief that we (and the League of California Cities) are correct in the opinion we have rendered, the interpretation of its provisions might be changed as case law is developed. If case law or other authority is developed which would change our view, we will promptly advise you of such a development.

CASEY GWINN, City Attorney

By

Theresa C. McAteer
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