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MEMORANDUM

TO: Bayron Gilchrist, SCAQMD
Barbara Baird, SCAQMD

FROM: Matthew D. Zinn
Winter King
Aaron M. Stanton

DATE: April 1, 2021

RE: Responses to comments submitted by the California Taxpayers Association

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You asked us to provide responses to the comments on Proposed Rule 2305 ("PR 2305") submitted by the California Taxpayers Association. The comments contend that PR 2305 and PR 316 impose special taxes in violation of Article XIII C of the California Constitution.[1] As explained further below, the proposed rules do not impose a special tax requiring a vote of the people under Proposition 26 and applicable case law. The letter acknowledges that not all charges are taxes, and non-tax charges need not be adopted by a vote of the people.

As an initial matter, the comment is correct that under Proposition 26, the District would bear the burden of demonstrating that the fees provided for the proposed rules are not taxes. Cal. Const. art. XIII C, § 1(e) (trailing paragraph). The District can carry that burden.

The in-lieu fee provided for in PR 2305 is not a tax primarily because it is not compulsory and provides a benefit to payors in the form of compliance flexibility. The definition of tax in Proposition 26 includes only charges "imposed" by public agencies. Cal. Const. art. XIII C, § 1(e). The in-lieu fee is not imposed by PR 2305: the rule does not require any warehouse owners or operators (i.e., covered entities) to pay that fee.

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[1] Although the letter lumps PR 2305 and 316 together, it provides no argument or supporting authority to explain why the administrative fee in PR 316 is a tax. Our responses below nevertheless explain why it is not.

The only circumstance in which a warehouse operator will pay the fee is if it *elects* to do so rather than using another source of Warehouse Actions and Investments to Reduce Emissions ("WAIRE") points. The obligatory portion of the proposed rule is the WAIRE Points Compliance Obligation ("WPCO"), and the in-lieu fee is only one route to satisfying an entity's WPCO. In *616 Croft Ave., LLC v. City of West Hollywood*, 3 Cal. App. 5th 621 (2016), the court confronted affordable housing fees that a developer could pay in lieu of complying with a requirement to set aside units as affordable housing. The court found "the fees are not compulsory because developers could choose the set-aside option" and therefore were not special taxes. *Id.* at 630-31; *see also id.* (holding that the in-lieu fee was paid "voluntarily as an *alternative* to setting aside a number of units").

The fee thus also provides payors with the privilege of avoiding the need to implement other measures to comply with PR 2305. California courts have repeatedly recognized that there is no right to pollute; that a regulated entity is allowed to continue polluting is thus a "privilege" and a "substantial benefit." *Cal. Chamber of Commerce v. State Air Res. Bd.*, 10 Cal. App. 5th 604, 645 (2017) ("*CalChamber*") (citing cases). Proposition 26's definition of tax includes an express exemption for charges paid in exchange for a "privilege granted directly to the payor that is not provided to those not charged." Cal. Const. art. XIII C, § 1(e)(1). Here, payment of the in-lieu fee provides the payor with WAIRE points equivalent to the payment, which can be used in satisfying the WPCO. Those points and their compliance benefits are not afforded to anyone other than the payor. Moreover, as required by the Proposition 26 exemption, the amount of the fee is based on an estimate of the cost of obtaining emission reductions comparable to those achieved by the WAIRE menu items. *See* Draft Staff Rep. at 33, 213; *see also Cal. Bldg. Indus. Ass'n v. San Joaquin Valley Unified Air Pollution Control Dist.*, 178 Cal. App. 4th 120, 128, 131-35 (2009) (upholding ISR fee based on the cost of offsetting the payors' emissions).

The fee will benefit payors in an additional way. The District will expend the fees, at least in part, to subsidize acquisition of low- and zero-emission trucks. Covered entities will further benefit from those expenditures to the extent those trucks make trips to warehouses regulated under PR 2305 because covered entities obtain credit for such visits through the WAIRE menu. This benefit is reflected in Scenario 7a analyzed in the Draft Staff Report, which concludes that it would substantially reduce the cost of compliance with the rule. Draft Staff Rep. at 61, 66-67.

The fee draws strong support from the *CalChamber* case, on which the comment letter repeatedly relies. *CalChamber* upheld the auction of greenhouse gas emission allowances under the State's cap-and-trade program against a claim that it imposed an unconstitutional tax. As the letter acknowledges, *CalChamber* held that

"generally speaking, a tax has two hallmarks: (1) it is compulsory, and (2) it does not grant any special benefit to the payor." 10 Cal. App. 5th at 640. First, the court concluded that participating in the auction was not compulsory because the cap-and-trade rule did not mandate that regulated entities bid at auction, and they had other options for reducing or meeting their compliance obligations. Second, it found that bidders obtained a valuable benefit in exchange for their bids: emission allowances that could be used for compliance with the cap-and-trade regulation. *Id.* at 646-49.

As noted above, PR 2305's in-lieu fee shares both features of the auction charge. The proposed rule does not require any covered entities to the pay the fee; they may instead obtain WAIRE points through a variety of methods. In addition, those that elect to pay the fee obtain WAIRE points in exchange—a valuable benefit that they would otherwise need to obtain by investing in other projects.

Moreover, in *California Building Industry Association v. City of San Jose*, 61 Cal. 4th 435 (2015), the California Supreme Court recognized that the availability of a constitutional option for complying with regulation means that a fee offered in lieu of compliance cannot be invalidated as unconstitutional. *Id.* at 468-69 (citing *Koontz v. St. Johns River Water Mgm't Dist.*, 133 S. Ct. 2586, 2599 (2013)). Here, PR 2305 offers covered entities the option to pay the in-lieu fee rather than implementing items from the WAIRE menu. The WAIRE menu items plainly do not impose an unconstitutional tax,[2] and thus the availability of that compliance option dictates that the in-lieu fee option cannot be invalidated as an unconstitutional tax. Indeed, because Article XIII C poses no obstacle to imposing the rule's regulatory obligation—the WPCO—if the position taken by the commenter were accepted by a court, the in lieu fee would be invalidated but the compliance obligation would remain. It would thus have the paradoxical effect of *reducing* flexibility for covered entities and thereby potentially *increasing* the costs of compliance for at least some covered entities.

Although the letter offers no analysis to support its contention that the administrative fee imposed by PR 316 is tax, it likewise is not a tax. It is a fee imposed to cover the costs to the District of administering a program to regulate the payors alone. Courts have routinely upheld such fees, including fees specifically to offset the costs of regulating air pollution. *See, e.g., San Diego Gas & Elec. Co. v. San Diego Cty. Air Pollution Control Dist.*, 203 Cal. App. 3d 1132, 1145-49 (1988). Here too, Proposition

[2] The letter is vague about whether the commenter contends that aspects of the rule other than the in-lieu fee impose a tax. However, the WAIRE menu items do not involve payments to the District and cannot be taxes for that reason, among others. *See Schmeer v. Cty. of Los Angeles*, 213 Cal. App. 4th 1310 (2013).

26 provides an applicable exemption from the definition of tax. Article XIII C, Section 1(e)(3) exempts "a charge imposed for the reasonable regulatory costs to a local government for issuing licenses and permits, performing investigations, inspections, and audits, enforcing agricultural marketing orders, and the administrative enforcement and adjudication thereof."

PR 316 allows the District to recoup the "reasonable regulatory costs" of implementing PR 2305—and those costs alone—from the entities subject to the program. First, it allows recovery of the District's estimated costs in processing reports and notices submitted by covered entities under PR 2305 and carrying out compliance activities including audits, inspections, and enforcement for covered entities. The fee "is equal to the level of effort required by South Coast AQMD staff to conduct compliance activities related to the reports for which the fees are being paid." Draft Staff Rep. at 38. This is consistent with the cases upholding fees imposed to recoup the direct costs of regulating payors. The fee does not fund unrelated District activities and is not imposed on any party that does not cause the District to incur the costs. *See S. Cal. Edison Co. v. Pub. Util. Comm'n*, 227 Cal. App. 4th 172, 199 (2014) (upholding fee against Proposition 26 challenge and holding that it "does not embrace fees charged in connection with regulatory activities which do not exceed the reasonable cost of providing services necessary to the activity for which the fee is charged and are not levied for unrelated revenue purposes"). It thus satisfies Proposition 26's requirement that the "costs [that] are allocated to a payor bear a fair or reasonable relationship to the payor's burdens on . . . the governmental activity." Cal. Const. art. XIII C, § 1(e) (trailing paragraph); *see also Griffith v. City of Santa Cruz*, 207 Cal. App. 4th 982, 996-97 (2012).

Second, PR 316 provides for a fee to be paid by covered entities that elect to pay the in-lieu fee or apply for approval of a custom WAIRE plan. Like the fees for processing submissions by covered entities, these fees do no more than recoup the administrative costs that the District incurs in implementing those portions of PR 2305. Furthermore, like the in-lieu fees themselves, these fees are only paid if a covered entity *elects* to use one of these alternatives to implementation of WAIRE menu items to satisfy their WPCO. As a result, these fees are not taxes for the reasons discussed above for the in-lieu fee. Moreover, the amount of the fees is calibrated to the District staff effort required to implement these tasks. *See* Draft Staff Rep. at 37.

The comment's reference to *Morning Star Co. v. Board of Equalization,* 201 Cal. App. 4th 737 (2011), is inapposite. The charge imposed in *Morning Star* was intentionally imposed as a tax to fund general operations of the Department of Toxic Substances Control. *Id.* at 755. The tax in *Morning Star* is plainly distinguishable from the fees in PR 2305 and PR 316. The PR 2305 in-lieu fee will not be used to fund

general District operations, as explained above, but rather to fund projects that reduce emissions or facilitate emission reductions to offset the same emissions caused by the payors' businesses. Likewise, the fees charged under PR 316 will recoup only the costs incurred by the District in implementing regulatory activities directly related to PR 2305. Unlike the tax in *Morning Star*, the District here is not funding its general operations at the payors' expense. On the contrary, the charges in PR 2305 and PR 316 are tailored to the cost of offsetting pollution associated with the payors' businesses and the cost of implementing regulation necessitated directly by the payors' activities.

The comment also asserts that the proposed rules impose taxes because they do not provide a sunset date and that a true regulatory requirement would supposedly include such a date. The comment points to no supporting case law or other legal authority for this novel contention, and we are aware of none. The District is under no legal obligation to adopt sunset dates for its regulations, and there is similarly no such obligation for fees offered in lieu of compliance obligations. Moreover, because the in-lieu fee is offered solely as an alternative mechanism for satisfying an operator's WPCO, the fee option will only remain available as long as covered entities have WPCOs. The duration of the fee is thus perfectly calibrated to the duration of the underlying regulatory obligation. If the District is successful in reducing emissions in the Basin sufficiently to attain the state and federal ambient air quality standards, the rule can be brought back to the District Board for reconsideration.

Surprisingly, the comment emphasizes the *CalChamber* case, discussed above, in which the Court of Appeal rejected a challenge to somewhat similar regulatory charge. The comment dramatically misconstrues the case. It argues the case established a new basis for concluding that a charge is a tax, when it instead found a new basis for concluding that a charge is *not* a tax. The commenter thus attempts to use a shield as a sword. The court held that the auction payments in *CalChamber* were not a tax in large measure because they were voluntary and were paid in exchange for benefits enjoyed solely by the bidders. The court thus upheld them despite the fact that they did not qualify as non-tax charges under the prior case law identifying several categories of non-tax fees. *See* 10 Cal. App. 5th at 639-40, 650. The court never suggested that all charges that are compulsory and do not provide a direct benefit to the payor are taxes. As discussed above, far from suggesting that the PR 2305 in-lieu fee is a tax, *CalChamber* strongly supports the conclusion that it is not.

Similarly, nothing in *CalChamber* holds or even implies that charges that are not "evenly distributed" across the population are taxes, as the commenter contends. The comment provides no citation to support that theory. On the contrary, the auction charge in *CalChamber* plainly was not evenly distributed: it was paid only by the

narrow group of bidders in the cap-and-trade auction and the amount of payments would differ based on bidders' demand for allowances.[3]

The comment also suggests that a charge can avoid being considered a tax only if its expenditure benefits only the payors. Here too, the comment cites no authority for this assertion. Neither *CalChamber* nor any other case of which we are aware supports that conclusion. In fact, the trailing paragraph of Article XIII C, Section 1(e) makes clear that a fee may be based on "the payor's burdens on, *or* benefits received from, the governmental activity." Cal. Const. art. XIII C, § 1(e) (emphasis added); *see also S. Cal. Edison Co.*, 227 Cal. App. 4th at 199. In any event, as discussed previously, the in-lieu fee does provide a benefit to payors in the form of regulatory flexibility.

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In sum, the proposed rules do not impose a tax under Article XIII C. The District is therefore not required to put them to a vote of the people, but rather may adopt them by a vote of the Governing Board.

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[3] In fact, because participation in the auction was not compulsory, the auction price was not even paid by all entities with a compliance obligation under the cap-and-trade program.