League of
California Cities

The California Municipal Law Handbook

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VII.
FINANCE

A. REVENUE

1. INTRODUCTION

a. CONSTITUTIONAL AUTHORITY

(1) IN GENERAL

The California Constitution provides express authority for the creation of, and the exercise of authority by, municipal corporations. Although the constitution delegates to the legislature authority to legislate on matters involving cities, it limits the ability of the legislature to interfere directly with the active management and operation of a municipal corporation, including revenue matters. The application of individual constitutional provisions are discussed in greater detail elsewhere. The following is provided as a general overview of pertinent constitutional provisions applicable to revenue matters.

(2) UNIFORM LAWS

Laws of a general nature must have uniform operation; special privileges and immunities are prohibited. Cal. Const. art. IV, § 16.

(3) LOCAL TAXING AUTHORITY

The legislature may authorize local governments to impose taxes for local purposes but may not impose such taxes itself. Cal. Const. art. XIII, § 24.

(4) NON-DELEGATION

The legislature may not delegate to any private party or body the power to make, control, appropriate, supervise or interfere with a city's improvements, money, property, to levy taxes or assessments, or to perform municipal functions. Cal. Const. art. XI, § 11(a); Howard Jarvis Taxpayers' Association, et al. v. Fresno Metropolitan Projects Authority, 40 Cal. App. 4th 1359, 48 Cal. Rptr. 2d 269 (1995).

(5) PROPERTY TAXES AND VOTER-APPROVAL REQUIREMENT FOR SPECIAL TAXES

The constitution establishes a one percent ad valorem property tax and requires a two-thirds vote for all special taxes. Cal. Const. art. XIIIA, § 1.

(6) APPROPRIATIONS LIMITS

A city's ability to appropriate the money it collects from the proceeds of taxes is subject to a constitutionally-defined limit. Cal. Const. art. XIIIB, § 1. Revenues from regulatory licenses and user charges or fees in excess of the reasonable costs of providing the regulation, product or service are included in proceeds of taxes. Cal. Const. art. XIIIB, § 8(c).

(7) DEBT LIMIT

The constitutional debt limit prohibits a city from incurring indebtedness beyond the city's ability to pay the debt back from revenues of the same fiscal year in which the debt is incurred. Cal. Const. art. XVI, § 18.

(8) GIFT OF PUBLIC FUNDS

The constitution prohibits gifts of public funds. Cal. Const. art. XVI, § 6. For example, an appropriation to pay a street contractor that rests on moral but not legal grounds is a gift of public funds and invalid. Conlin v. Board of Supervisors of the City and County of San Francisco, 99 Cal. 17, 33 P. 753 (1893), 114 Cal. 404, 46 P. 279 (1896). However, the prohibition does not preclude expenditures and disbursements for public purposes even if a private person incidentally benefits. Redevelopment Agency v. Shepard, 75 Cal. App. 3d 453, 457 142 Cal. Rptr. 212 (1977).

b. COMMON LAW AUTHORITY

Municipal corporations in California do not have common law powers, but only such powers as are expressly granted by the constitution, general law or the city charter and such powers necessary or indispensable to carry out express powers and the purpose of the city. Legault v. Board of Trustees, 161 Cal. 197, 118 P. 706 (1911); City of Long Beach v. Lisenby, 175 Cal. 575, 166 P. 333 (1917). A general law city has only those powers expressly conferred by the legislature together with powers which are necessary and indispensable thereto. Irwin v. City of Manhattan Beach, 65 Cal. 2d 13, 20, 51 Cal. Rptr. 881 (1966). See generally, Myers v. City Council of Pismo Beach, 241 Cal. App. 2d 237, 240, 50 Cal. Rptr. 402 (1966) (no inherent power of municipal taxation); Ex parte Braun, 141 Cal. 204, 74 P. 780 (1903) (power to tax is derived from the constitution, general laws or the charter); City of Grass Valley v. Walkinshaw, 34 Cal. 2d 595, 600, 212 P.2d 894 (1949) (power to tax may be implied from authority to incur bonded indebtedness); City of Inglewood v. Kew, 21 Cal. App. 611, 132 P. 780 (1913) (compliance with statutory provisions to issue bonds is mandatory); Law v. San Francisco, 144 Cal. 384, 77 P. 1014 (1904) (charter provisions for bonded indebtedness prevail over general laws); Willmon v. Powell, 91 Cal. App. 1, 266 P. 1029 (1928) (absent constitutional restriction, a city charter may expressly authorize issuance of bonds for municipal purposes).

c. STATUTORY AUTHORITY

Statutory authority regulating local government revenue and fiscal affairs is extensive, far too extensive to cover in a short introduction. Except in the area of local taxation and California Constitution article XIIIB, the various enabling statutes are codified by subject matter and are reasonably easy to find and reasonably straightforward in application. The characterization of revenue matters as a municipal affair has been significantly changed by California Federal Savings and Loan Assn. v. City of Los Angeles, 54 Cal. 3d 1, 283 Cal. Rptr. 569 (1991). In that case, the court shifted the analysis from the nature of the municipality's action (imposing a business license tax) to the impact of this action (whether the increased tax burden on financial corporations was of "sufficient extramural dimension" to warrant preemption by state law). Because the power to tax or otherwise raise revenue is based on the constitution and the general laws, specific authorization must be found before proceeding.

2. TAXES

a. GENERAL TAXES

(1) INTRODUCTION

(a) IN GENERAL. It has long been recognized that a municipality must be able to raise money in order to be more than "a body without life, incapable of acting, and serving no useful purpose." 15 McQuillin, Municipal Corporations (3d rev. ed.) § 39.01.

(b) POWER OF TAXATION. All cities, whether charter or general law, have the power to tax. Cal. Const. art. XI, § 5 (charter cities); Cal. Gov't Code § 37100.5 (general law cities). Issues most likely to arise in this area are constitutional limitations on taxation, such as Proposition 13. A "general tax" is a tax placed into the general fund for any and all municipal purposes. Neecke v. City of Mill Valley, 39 Cal. App. 4th 946, 46 Cal. Rptr. 2d 266 (1995). The imposition of general taxes is also subject to the provisions of Propositions 62 and 218 which require, among other things, a two-thirds vote of the legislative body, a majority vote of the voters voting in an election on the tax and the consolidation of such an election with a regularly scheduled general election for members of the city council. Cal. Gov't Code § 53724; Cal. Const. art. XIIIC, § 2(b). (See sections VII.A.2.c.5. and VII.A.2.c.6. of this handbook.) The supermajority vote requirement for a "special tax" is not imposed upon a tax measure simply because it appears on the same ballot with a separate advisory measure for voters' preference on how to spend the new tax revenues. Coleman v. County of Santa Clara, 64 Cal. App. 4th 662, 75 Cal. Rptr. 2d 516 (1998). (See section VII.A.2.c. of this handbook.)

(c) POLICE POWER. Distinguished from the tax power is the police power. The most common example of a financial expression of the police power is the regulatory fee; however, cities also have the ability to prohibit conduct entirely and prescribe penalties or fines as a means of enforcing their laws. Perhaps one of the primary issues arising in this category of municipal authority is the calculation of a regulatory fee. If the fee exceeds the estimated cost of the service being provided, it may be declared a tax and subjected to voter-approval requirements. Sinclair Paint Co. v. State Board of Equalization, 15 Cal. 4th 866, 64 Cal. Rptr. 2d 447 (1997). (See section VII.A. 6. of this handbook, below.) Courts have sustained revenue-raising activities under the police power. Trent Meredith v. City of Oxnard, 114 Cal. App. 3d 317, 327, 170 Cal. Rptr. 685, 690-691 (1981).

(d) OTHER POWERS. Beyond the police and taxation powers, the raising, maintaining and appropriating of revenue requires cities to exercise their corporate and public works powers. See e.g., Cal. Gov't Code § 53731.

(2) PROPERTY TAX

(a) PRIOR TO 1978. Under the California Constitution and the California Revenue and Taxation Code, all property in California not otherwise free from tax under federal law or California law is subject to taxation "in proportion to its full value." Cal. Const. art. XIII, § 1; Cal. Rev. & Tax. Code § 201. This Constitutional provision has been interpreted to mean that a non-ad valorem property tax was unconstitutional. Thomas v. City of East Palo Alto, 53 Cal. App. 4th 1084, 62 Cal. Rptr. 2d 185 (1997).

(b) AFTER 1978. The passage of Proposition 13, Cal. Const. art. XIIIA, dramatically changed property taxation in California. It limited ad valorem property taxes to one percent of the full cash value of the property. The one percent tax is collected by the counties and is apportioned to the taxing agencies within the counties. Cal. Const. art. XIIIA, § 1(a); Cal. Rev. & Tax. Code §§ 95 et seq.

(c) CONSTITUTIONALITY. Proposition 13's methods for assessing property taxes have been upheld against constitutional attacks. See Nordlinger v. Hahn, 505 U.S. 1, 112 S. Ct. 2326, 120 L. Ed. 2d 1 (1992); Amador Valley Joint Union High School District v. State Board of Equalization, 22 Cal. 3d 208, 149 Cal. Rptr. 239 (1978).

(d) DEFINITION OF FULL CASH VALUE. "[T]he county assessor's valuation of real property as shown on the 1975-76 tax bill . . . or, thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment . . ." Cal. Const. art XIIIA, § 2(a). The implementing legislation for Proposition 13 defined full cash value or fair market value as ". . . the amount of cash or its equivalent that property would bring if exposed for sale in the open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other and both with knowledge of all the uses and purposes to which the property is adapted and for which it is capable of being used and of the enforceable restrictions upon those uses and purposes." Cal. Rev. & Tax. Code § 110(a).

(e) EXCEPTIONS TO THE ONE PERCENT RULE. The one percent limit does not apply to ad valorem property taxes or special assessments to pay interest on two kinds of indebtedness:

i) Indebtedness approved by the voters before July 1, 1978; and

ii) Indebtedness for the acquisition or improvement of real property approved by the voters after July 1, 1978 by a two-thirds vote.

Cal. Const. art. XIIIA, § 1(b).

(f) CHARACTERISTICS OF A PROPERTY TAX

i) TAXES OWNERSHIP. A property tax taxes ownership in all its incidents; the tax is levied without regard to the use to which the property is put. Douglas Aircraft Company, Inc. v. Johnson, 13 Cal. 2d 545, 90 P.2d 572 (1939).

ii) ANNUAL. Property taxes recur annually on a fixed date. City of Huntington Beach v. Superior Court of Orange County, 78 Cal. App. 3d 333, 144 Cal. Rptr. 236 (1978).

iii) NO PERSONAL LIABILITY. Generally, property taxes trigger no personal liability but are secured by the property taxed. City of Huntington Beach v. Superior Court of Orange County, 78 Cal. App. 3d 333, 144 Cal. Rptr. 236 (1978).

iv) DISTINCTION BETWEEN A PROPERTY TAX AND AN EXCISE TAX. A property tax taxes ownership per se without conditions. An excise tax is a tax on the privilege of exercising one or more incidents of ownership. City of Huntington Beach v. Superior Court of Orange County, 78 Cal. App. 3d 333, 144 Cal. Rptr. 236 (1978). A parcel tax (designed to raise revenue for the support of general municipal services and characterized as an excise tax) was a non-ad valorem property tax prohibited by article XIII, section 1 of the California Constitution which requires property be taxed on the basis of value. Thomas v. City of East Palo Alto, 53 Cal. App. 4th 1084, 62 Cal. Rptr. 2d 185 (1997). But see Cal. Const. art. XIIID, § 3.

(g) EXEMPTIONS. Some kinds of property are exempt from taxation. These include property owned by the state, see Cal. Const. art. XIII, § 3(a), most property owned by local government, see Cal. Const. art. XIII, §§ 3(b), 11, libraries and museums, see Cal. Const. art. XIII, § 3(d), and property used for certain kinds of schools, see Cal. Const. art. XIII, §§ 3(d), (e), and churches, see Cal. Const. art. XIII, § 3(f). An excise tax imposed on taxpayers who are exempt from the payment of a property tax may be seen as an unconstitutional tax on a tax-exempt entity. Sacramento Municipal Utility Dist. v. County of Solano, 54 Cal. App. 4th 1163, 63 Cal. Rptr. 3d 286 (1997).

(h) POSSESSORY INTEREST TAX. State law authorizes counties to tax, on an ad valorem basis, private possessory interests in real property owned by governmental entities. See Cal. Rev. & Tax. Code § 107. The purpose of such taxation is to protect the public domain from private profit without tax liability. United Air Lines v. County of San Diego, 1 Cal. App. 4th 418, 2 Cal. Rptr. 2d 212 (1991). See also United States v. County of San Diego, 965 F.2d 691 (9th Cir. 1992).

(i) TAXATION OF CITY PROPERTY. A city must pay property tax on property which it owns and which is located outside its boundaries. Cal. Const. art. XIII, §11. The amount of such tax is, however, subject to the limits of Proposition 13. City and County of San Francisco v. County of San Mateo, 10 Cal. 4th 554, 41 Cal. Rptr. 2d 888 (1995).

PRACTICE TIP: Public agencies should include a clause in any contract that may create a taxable possessory interest notifying the private party it may be subject to a possessory interest tax pursuant to California Revenue and Taxation Code section 107.6.

(3) SALES AND USE TAX

(a) PREEMPTION. The legislature has preempted the field of sales and use taxation in the name of statewide uniformity. See generally Cal. Rev. & Tax. Code §§ 7200 et seq. (Bradley-Burns Uniform Sales and Use Tax Law). Cities must impose sales taxes in accordance with state law. See Cal. Rev. & Tax. Code §§ 6001, 7202(c). Furthermore, cities may only impose a sales and use tax if the county in which they are located imposes a sales and use tax. Cal. Rev. & Tax. Code §§ 7200 et seq.; 53 Cal. Op. Att'y Gen. 292 (1970).

(b) DEFINITIONS.

i) SALES TAX. A tax imposed for the privilege of selling tangible personal property at retail. Cal. Rev. & Tax. Code § 7202(h)(l).

ii) USE TAX. A tax imposed upon the storage, use or other consumption in the city of tangible personal property purchased from a retailer without being subject to sales tax. Cal. Rev. & Tax. Code § 7202(h)(1).

(c) TAX RATE. A city's sales and use tax rate cannot exceed one percent. Cal. Rev. & Tax. Code § 7202(h)(1). The local sales and use tax rate may exceed one percent if any of the special statutory authorizations to do so have been used. See, e.g., Cal. Gov't Code §§ 26290 et seq. (San Joaquin County Justice facilities); Cal. Rev. & Tax. Code §§ 7285.5 (the county authority to adopt a 0.25 or 0.5 percent tax for "general purposes"); 7261 (county-wide transportation taxes); 7288.1 (public education, drug abuse and crime prevention, and health care). An uncodified section of Chapter 1257 of the Statutes of 1987 limits the combined rate of special statutory authorizations to 2.25 percent.

(d) PROCEEDS FROM SALES AND USE TAX. All money received from city-imposed sales and use tax must be paid to the general fund, or if imposed pursuant to statutory authority to repay bonds (e.g., Cal. Gov't Code §§ 50665.1 et seq.), into a special fund or funds for such purpose or purposes as established by ordinance. Cal. Gov't Code § 43401. Revenues from that portion of the sales tax imposed by state law for the Local Public Safety Fund, Cal. Const. Art. XIII, § 35, may be spent only on public safety services, Cal. Gov't Code § 30052, and may be forfeited if the city decreases funding for such services below that amount funded in fiscal year 1992-93. Cal. Gov't Code § 30056.

(e) SALES TAX SHARING AMONG GOVERNMENTAL ENTITIES. Agreements to share sales and use tax proceeds among cities and counties may be accomplished by voter-approval or a two thirds vote of the legislative body of each participating jurisdiction. Cal. Const. art. XIII, § 29. See also Cal. Gov't Code §§ 55700-55707.

(f) TRANSACTIONS AND USE TAXES COMBINED WITH AUTHORIZATION TO INCREASE SALES TAX FOR TRANSIT AND OTHER SPECIFIED PURPOSES. See Cal. Rev. & Tax. Code §§ 7251 et seq.; Rider v. County of San Diego, 1 Cal. 4th 1, 2 Cal. Rptr. 2d 490 (1991).

(4) PAYROLL TAX

(a) INTRODUCTION. Cities may not impose an income tax, but may levy an employee license tax based on gross earnings within the jurisdiction.

(b) STATUTORY PROVISIONS. Cities may not levy an income tax, but this does not "prohibit the levy or collection of any otherwise authorized license tax upon a business measured by or according to gross receipts." Cal. Rev. & Tax. Code § 17041.5. Cities may not tax earnings in a way which discriminates against non-residents. Cal. Gov't Code § 50026. See also County of Alameda v. City and County of San Francisco, 19 Cal. App. 3d 750, 97 Cal. Rptr. 175 (1971).

(c) CHARTER CITIES. Under their home rule powers, charter cities may impose a license tax on employees based on their gross earnings within the jurisdiction; the tax should not be graduated and should have none of the deductions typical of an income tax. Weekes v. City of Oakland, 21 Cal. 3d 386, 146 Cal. Rptr. 558 (1978).

(d) GENERAL LAW CITIES. General law cities may levy any tax which may be levied by a charter city, see Cal. Gov't Code § 37100.5, and therefore apparently may also impose this tax. See Fenton v. City of Delano, 162 Cal. App. 3d 400, 208 Cal. Rptr. 486 (1984) (upholding utility taxes).

(e) OTHER ISSUES. An employee license fee is not an additional and illegal tax when assessed against alcoholic beverage sellers. A.B.C. Distributing Company v. City and County of San Francisco, 15 Cal. 3d 566, 125 Cal. Rptr. 465 (1975).

(5) BUSINESS LICENSE TAXES

(a) GENERAL LAW CITIES. A general law city may levy business license taxes for regulatory purposes or for revenue purposes or for both. Cal. Gov't Code § 37101 (1992). See also Cal. Bus. & Prof. Code §§ 16000 et seq.

(b) CHARTER CITIES. Charter cities have power to impose business license taxes subject only to the restrictions of the limitations in the state and federal constitutions and their own city charters. See Cal. Const. art. XI, § 5.

(c) PREEMPTION. The levy and collection of taxes is a "municipal affair." Fox Bakersfield Theatre Corporation v. City of Bakersfield, 36 Cal. 2d 136, 222 P.2d 879 (1950). However, aspects of local taxation may under some circumstances acquire a "super-municipal" dimension, transforming an otherwise municipal concern into a statewide concern. California Federal Savings and Loan Assn. v. City of Los Angeles, 54 Cal. 3d 1, 283 Cal. Rptr. 569 (1991) (finding financial corporations are subject only to the in lieu state income tax).

(d) REVENUE-RAISING VERSUS REGULATORY MUNICIPAL LEGISLATION. A city may enforce a licensing ordinance against a person doing business within the city where such ordinance was solely enacted to raise money for municipal purposes; such taxation is not excluded merely because the state has occupied the field of regulation. Moreover, a city business tax ordinance providing for criminal penalties in the form of fines, forfeitures and penalties is not invalid for that reason. Arnke v. City of Berkeley, 185 Cal. App. 2d 842, 8 Cal. Rptr. 645 (1960).

PRACTICE TIP: Regulatory fees are limited by the cost of administering the regulatory program; to avoid this limitation, the language of a tax ordinance should state the ordinance "is not intended for the purpose of regulation."

(e) APPORTIONMENT BETWEEN INTRA-CITY AND OUT-OF-CITY BUSINESS ACTIVITIES. A city may tax a business which is partially located outside the city's jurisdictional boundaries only if the business license tax is fairly reflects that proportion of activity carried on within the city. Cal. Bus. & Prof. Code § 16000.

i) SOURCE OF REQUIREMENT. Apportionment is required by the California Constitution's provisions forbidding extraterritorial application of laws and guaranteeing equal protection and by comparable provisions of the federal Constitution. City of Los Angeles v. Shell Oil Company, 4 Cal. 3d 108, 93 Cal. Rptr. 1, cert. denied, 404 U.S. 831, 92 S. Ct. 73 (1971).

ii) APPORTIONMENT METHODOLOGY. The apportionment must be based on a measure which "fairly reflects that proportion of the taxed activity which is actually carried on within the taxing jurisdiction." Shell Oil, 4 Cal. 3d at 124. The measure of the license fee must be based on events occurring wholly within the city (e.g., gross receipts from intra-city sales or storage) or the ratio of in-city to out-of-city business activities. General Motors Corporation v. City of Los Angeles, 5 Cal. 3d 229, 242-243, 95 Cal. Rptr. 635 (1971). Accord, City of San Jose v. Ruthroff & Englekirk, etc., Engineers, Inc., 131 Cal. App. 3d 462, 183 Cal. Rptr. 391 (1982).

iii) BURDEN OF PROOF. A taxpayer who contends a city's business license tax improperly taxes significant extraterritorial values bears the burden of proof. Volkswagen Pacific, Inc. v. City of Los Angeles, 7 Cal. 3d 48, 58, 101 Cal. Rptr. 869 (1972). The taxpayer must show by "clear and cogent evidence" such fee does not fairly reflect the intra-city proportion of the relevant taxed activity. City of Los Angeles v. Moore Business Forms, Inc., 247 Cal. App. 2d 353, 55 Cal. Rptr. 820 (1966). Accord, Park 'N Fly of San Francisco, Inc. v. City of South San Francisco, 188 Cal. App. 3d 1201, 234 Cal. Rptr. 23 (1987).

(f) TAXABLE EVENT. A city is constitutionally free to tax the business presence within its jurisdiction by reference to the "taxable events" occurring there. Even though the city has the constitutional authority to tax a business presence, the imposition of a tax may be found invalid if the tax ordinance is not explicit in its application. Fox Bakersfield Theatre Corporation v. City of Bakersfield, 36 Cal. 2d 136, 222 P.2d 879 (1950). For example, a city could tax manufacturing by reference to total gross receipts as well as handling or storage within the city by reference to the same gross receipts.

(g) REASONABLE CONNECTION WITH THE TAXABLE EVENT. The measure of taxation must not be "capricious, arbitrary or discriminatory." See Security Truck Line v. City of Monterey, 117 Cal. App. 2d 441, 256 P.2d 366 (1953) (invalidating tax on each vehicle of firm; a better measure would have been number of deliveries or the tonnage carried by trucks). A business tax may be based on the preceding year's calendar gross receipts. Web Service Company, Inc. v. Spencer, 252 Cal. App. 2d 827, 61 Cal. Rptr. 493 (1967).

(h) AMOUNT OF TAX. There is no requirement that an excise tax levied for revenue by a municipality be reasonable in amount. The only restrictions on the exercise of a power to impose a tax are the constitution, the charter for charter cities, and the statutes for general law cities. Fox Bakersfield Theatre Corporation v. City of Bakersfield, 36 Cal. 2d 136, 222 P.2d 879 (1950). There is, of course, the overriding limitation a tax may not be prohibitive or confiscatory.

(i) THE POSSIBILITY OF DUPLICATION BY ANOTHER TAXING JURISDICTION TAXING THE SAME ACTIVITY. See General Motors Corporation v. City of Los Angeles, 5 Cal. 3d 229, 95 Cal. Rptr. 635 (1971) (invalidating tax on taxpayer with no place of business within the taxing entity where tax was levied on total unapportioned gross receipts solely because deliveries were shipped into city).

(j) A MINIMUM TAX. See City of San Jose v. Ruthroff & Englekirk, etc., Engineers, Inc., 131 Cal. App. 3d 462, 183 Cal. Rptr. 391 (1982) (invalidating minimum tax on an engineering firm with office outside city whose employees spent total of 12 hours in city during taxable year, even though firm had a contract to perform services for project in city).

(k) NEXUS/MINIMUM CONTACTS. In order for a municipality to properly tax an entity, the latter must have a substantial presence within the city's jurisdictional borders. See Mobil Oil Corporation v. Commissioner of Taxes, 445 U.S. 425, 100 S. Ct. 1223, 1231 (1980). See also Moorman Manufacturing Company v. Bair, 437 U.S. 267, 272-273, 98 S. Ct. 2340, 2344, 57 L. Ed. 2d 197 (1978) (requiring: (1) a "minimal connection" between the interstate activities and the taxing state, and (2) a rational relationship between the income attributed to the state and the intrastate values of the enterprise).

(l) CLASSIFICATION/DISCRIMINATION. No constitutional rights are violated if the burden of a license tax falls equally on all members of a class, though other classes have lighter burdens or are wholly exempt. The classification must be reasonable, must be based on substantial differences between the pursuits separately grouped and must not be arbitrary. See U.S. Const. amend. XIV (equal protection clause); Fox Bakersfield Theatre Corporation v. City of Bakersfield, 36 Cal. 2d 136, 222 P.2d 879 (1950).

PRACTICE TIP: Oakland apportions the gross receipts of radio and television broadcasting companies as well as the newspaper publishing firms located within its borders. For newspapers, the city imposes a tax on 100 percent of the receipts attributable to its newspaper circulation within the city and applies the appropriate tax rate to only 30 percent of the balance of their gross receipts as it is deemed such gross receipts are attributable to sales outside the city. For broadcasters, independent surveys will be used to determine the portion of gross receipts attributable to out-of-city reception households; then 30 percent of such receipts will be taxable. For related material, please see section V.F.2.b.(5) (relating to First Amendment issues) of this handbook.

(6) UTILITY USERS' TAX

(a) INTRODUCTION. Cities may impose a tax on utilities such as gas, electricity, telephone, water and cable television. Charter cities may impose a utility users tax under their home rule authority. See Cal. Const. art. XI, § 5. General law cities may levy any tax which may be levied by a charter city. Cal. Gov't Code § 37100.5; Fenton v. City of Delano, 162 Cal. App. 3d 400, 208 Cal. Rptr. 486 (1984) (upholding general law city utility users tax).

(b) COLLECTION. Charter cities' constitutional power to tax carries with it the corollary power to use reasonable means to effect collection, including having others collect the tax and remit it to city. See City of Modesto v. Modesto Irrigation District, 34 Cal. App. 3d 504, 110 Cal. Rptr. 111 (1973). General law cities have the same taxing authority as charter cities, see Cal. Gov't Code § 37100.5, and therefore presumably have the same authority to require collection and remittance of the tax by others. See also Cal. Penal Code § 424 (making it a felony to refuse to pay over public money received under a duty to pay it over). However, a city requiring another entity to collect its utility users' tax must compensate that entity for the cost of doing so. See Edgemont Community Services District v. City of Moreno Valley, 36 Cal. App. 4th 1157, 42 Cal. Rptr. 2d 823 (1995).

(7) TRANSIENT OCCUPANCY TAX

(a) INTRODUCTION. Cities and counties may tax persons staying 30 days or less in hotels, motels and similar lodgings, including mobile homes. See Cal. Rev. & Tax. Code §§ 7280 et seq. Some cities include a specific amount as well as a percentage. Special provisions apply to redevelopment agencies. See Cal. Rev. & Tax. Code § 7280.5.

(b) DRAFTING ISSUES. Care must be taken in the way transient occupancy tax ordinances are drafted. See Britt v. City of Pomona, 223 Cal. App. 3d 265, 272 Cal. Rptr. 724 (1990) (finding constitutional fault with the way in which one city's transient occupancy tax ordinance was drafted). See also City of San Diego v. De Leeuw, 12 Cal. App. 4th 10, 15 Cal. Rptr. 2d 98 (1993) (analyzing successor-in-interest issues).

(c) EXEMPTIONS. Special requirements apply to time-shares, see Cal. Rev. & Tax. Code § 7280(b), and campgrounds. See Cal. Rev. & Tax. Code § 7280(b) and (c). The tax applies to state and federal employees traveling on business even if their room charges are paid directly by their governmental employer. See 75 Cal. Op. Att'y Gen. 86 (1992); 46 Cal. Op. Att'y Gen. 16 (1965).

(d) IDENTITY OF OCCUPANT. The ordinance should specify the actual occupant being taxed, so a business does not rent a room in its name for more than 30 days to avoid the tax. See Gowens v. Bakersfield, 193 Cal. App. 2d 79, 13 Cal. Rptr. 820 (1961).

(e) COLLECTION. Charter cities' constitutional power to tax carries with it the corollary power to use reasonable means to effect collection, including having others collect the tax and remit it to city. See City of Modesto v. Modesto Irrigation District, 34 Cal. App. 3d 504, 110 Cal. Rptr. 111 (1973). General law cities have the same taxing authority as charter cities, see Cal. Gov't Code § 37100.5, and therefore presumably have the same authority to require collection and remittance of the tax by others. Cities may allow the operator to keep a portion of the tax as a collection fee. See 48 Cal. Op. Att'y Gen. 109 (1966). See also Cal. Penal Code § 424 (making it a felony to refuse to pay over public money received under a duty to pay it over).

PRACTICE TIPS:

1. The state Board of Equalization may tax the imputed value of breakfasts included in a room rate. Frequent audits, tough penalty enforcement and prompt collections are important.

2. The ordinance imposing a transient occupancy tax should provide if a remittance is not paid when due, the schedule for making future remittances is automatically shortened to a weekly or even daily schedule.

3. The ordinance imposing a transient occupancy tax should provide that the operator hold such tax in trust for the city.

(8) OTHER EXCISE TAXES

(a) DEFINITION. "In its modern sense an excise tax is any tax which does not fall within the classification of a poll tax or a property tax, and which embraces every form of burden not laid directly upon person or property. The obligation to pay an excise tax is based upon the voluntary action of the person taxed in performing the act, enjoying the privilege, or engaging in the occupation which is the subject of the excise tax, and the element of absolute and unavoidable demand is lacking." 71 Am. Jur. 2d, § 26. See also Pesola v. City of Los Angeles, 54 Cal. App. 3d 479, 126 Cal. Rptr. 580 (1975).

(b) EXAMPLES. Excise taxes include the sales and use tax, business license tax, utility user tax, transient occupancy tax, real property transfer tax, admissions tax and development (or bedroom) tax. The phrase "excise tax" is most commonly used in reference to a type of parcel tax. Excise taxes are sometimes referred to as license or privilege taxes.

(c) AUTHORITY. The source of excise taxing authority for a charter city is the city's general home rule powers, see Cal. Const. art. XI, § 5, and the city's charter. The general authority for a general law city to levy an excise tax is California Government Code sections 37100.5 and 50075; for specific statutory authority for some taxes, see discussion of specific taxes under section VII.A.2.a. of this handbook.

(d) LIMITATIONS. Excise taxes are subject to the limitations discussed in section VII.A.2.c. of this handbook.

(e) PROPERTY TAXES DISTINGUISHED

i) IMPORTANCE OF DISTINCTION. It is often crucial to distinguish an excise tax from a property tax. If a tax is categorized by a court as a property tax, it may be struck down as a violation of article XIIIA, section 1 of the California Constitution requiring property taxes to be based on value or as a "double tax" on property. See City of Oakland v. Digre, 205 Cal. App. 3d 99, 252 Cal. Rptr. 99 (1988); Flynn v. San Francisco, 18 Cal. 2d 210, 115 P.2d 3 (1941). These issues arise most frequently in relation to a parcel tax.

ii) GENERAL DISTINCTION. A property tax is a tax directly on property. An excise tax is a tax upon the exercise of an incident of ownership. City of Huntington Beach v. Superior Court of Orange County, 78 Cal. App. 3d 333, 144 Cal. Rptr. 236 (1978); City of Oakland v. Digre, 205 Cal. App. 3d 99, 252 Cal. Rptr. 99 (1988); Flynn v. San Francisco, 18 Cal. 2d 210, 115 P.2d 3 (1941); Brunton v. Superior Court, 20 Cal. 2d 202, 124 P.2d 831 (1942); Douglas Aircraft Company v. Johnson, 13 Cal. 2d 545, 90 P.2d 572 (1939).

iii) FACTORS IN DETERMINING TYPE OF TAX. Courts have looked at the following factors in determining whether a tax qualifies as an excise (as opposed to property) tax:

a) Name given to tax upon enactment (not controlling);

b) Property tax collected regularly; excise tax collected upon exercise of an incident of ownership (e.g., transfer or use);

c) Property tax generally is imposed on owner; excise tax may be imposed on occupant or other person exercising an incident of ownership;

d) If the tax is imposed on the use of services, an excise tax is imposed in proportion to the extent of the use of those services (but see discussion in section VII.B.2.a. of this handbook below); and

e) A property tax is a lien on property rather than a personal debt and is collected with other property taxes; an excise tax is a personal debt.

See generally City of Huntington Beach v. Superior Court of Orange County, 78 Cal. App. 3d 333, 144 Cal. Rptr. 236 (1978); City of Oakland v. Digre, 205 Cal. App. 3d 99, 252 Cal. Rptr. 99 (1988); Flynn v. San Francisco, 18 Cal. 2d 210, 115 P.2d 3 (1941).

(f) DEVELOPMENT TAX

i) DEFINITION. A development or bedroom tax is an excise tax on the privilege or activity of development and/or the availability or use of municipal services. The tax is generally imposed only on new construction. The tax rate is generally based on number of units, number of bedrooms or square footage.

ii) AUTHORITY. The source of authority to levy a development tax for a charter city is the city's general home rule powers, see Cal. Const. art. XI, § 5, and the city's charter. The general authority for a general law city to levy such a tax is California Government Code sections 37100.5 and 50075.

iii) VALIDITY. Several cases have upheld the validity of an excise tax on development. See The Pines v. Santa Monica, 29 Cal. 3d 656, 175 Cal. Rptr. 336 (1981); Associated Home Builders of the Greater East Bay v. City of Newark, 18 Cal. App. 3d 107, 95 Cal. Rptr. 648 (1971); Westfield-Palos Verdes Company v. City of Rancho Palos Verdes, 73 Cal. App. 3d 486, 141 Cal. Rptr. 36 (1977). Such a tax is not a development fee and therefore not subject to or prohibited by California Government Code sections 66000 et seq. Centex Real Estate Corp. v. City of Vallejo, 19 Cal. App. 4th 1358, 24 Cal. Rptr. 2d 48 (1993).

iv) IMPACT FEES DISTINGUISHED. Development fees must be adopted pursuant to California Government Code sections 66000 et seq., are intended to mitigate the impacts of development, and must not exceed the cost of providing the services or facilities necessitated by the development; proceeds from development fees must be spent on such services or facilities. (See section V.B.9 of this handbook, above.) In contrast, development taxes are imposed for revenue-raising purposes. A true fee cannot be characterized as a tax for the purpose of circumventing limitations on fees. California Building Industry Association v. Governing Board of the Newhall School District of Los Angeles County, 206 Cal. App. 3d 212, 253 Cal. Rptr. 497 (1988).

PRACTICE TIP: A development tax ordinance should state it is adopted for general fund revenue-raising purposes and it is not a fee intended to mitigate the impacts of development.

(g) ADMISSIONS TAX

i) DEFINITION. An admissions tax is a tax imposed on the consumer for the privilege of attending a show, performance, display or exhibition. The tax rate is generally based on either a flat rate per ticket, a percentage of the admission price, or on a sliding scale. The tax is included in the price of the ticket, collected by the ticket seller and remitted by the seller to the city.

ii)) AUTHORITY. The source of authority to levy an admissions tax for a charter city is the city's general home rule powers, see Cal. Const. art. XI, § 5, and the city's charter. The general authority for a general law city to levy such a tax is California Government Code sections 37100.5 and 50075.

iii) VALIDITY. An admissions tax imposed on businesses was upheld in Fox Bakersfield Theatre Corporation v. City of Bakersfield, 36 Cal. 2d 136, 222 P.2d 879 (1950). However, more recent cases have struck down admissions taxes which are borne solely or primarily by activities protected by the First Amendment on an "as applied" basis. See Festival Enterprises, Inc. v. City of Pleasant Hill, 182 Cal. App. 3d 960, 227 Cal. Rptr. 601 (1986); United Artists Communications, Inc. v. City of Montclair, 209 Cal. App. 3d 245, 257 Cal. Rptr. 124 (1989). These cases suggest a city must have substantial businesses or events which do not involve First Amendment rights which would bear a significant portion of the tax burden in order to enact an admissions tax, or demonstrate a compelling interest, other than the mere need to raise revenue, if a tax targets First Amendment businesses. Sacramento Cable Television v. City of Sacramento, 234 Cal. App. 3d 232, 286 Cal. Rptr. 470 (1991).

(9) PARCEL TAX

(a) NATURE OF TAX. A parcel tax is either a special tax or a general tax in the form of excise tax and is generally an annual tax which is based on either a flat per-parcel rate or a rate which varies depending upon use, size and/or number of units on each parcel. However, Proposition 218 may require that a parcel tax be adopted as a special tax. See Cal. Const. art. XIIID, § 3.

(b) AUTHORITY. The source of authority to levy a parcel tax for a charter city is the city's general home rule powers, see Cal. Const. art. XI, § 5, and the city's charter. The general authority for a general law city to levy such a tax is California Government Code sections 37100.5 and 50075.

(c) DISTINCTION FROM PROPERTY TAX. A parcel tax in the nature of an ad valorem property tax is invalid, as a violation of the one percent limit on ad valorem property taxes. Cal. Const. art. XIIIA, § 1. A parcel tax in the nature of a non-ad valorem property tax is invalid, as a violation of Cal. Const. art XIII, § 1. A parcel tax which may be invalidated either as an ad valorem tax in excess of the one percent limitation of Cal. Const. art XIIIA, § 1, or as a non-ad valorem property tax may be valid if approved as a special tax by the voters pursuant to Cal. Const. art. XIIIA, § 4 and art. XIIID, § 3(a)(2). See Heckendorn v. City of San Marino, 42 Cal. 3d 481, 229 Cal. Rptr. 324 (1986).

(d) EXCISE TAX. Most parcel taxes are adopted as excise taxes. See section VII.A.2.a.(8) of this handbook for a discussion of excise taxes generally.

i) BASIS. Ordinances adopting parcel taxes commonly provide they are an excise tax based on the availability or use of municipal services and/or facilities. The basis may be a variety of existing facilities and services (see, for example, City of Oakland v. Digre, 205 Cal. App. 3d 99, 252 Cal. Rptr. 99 (1988)) or new facilities which are being financed through the imposition of a special parcel tax (for example, as part of a Mello-Roos district). The taxpayer need not actually use the services, but can be required to pay the tax based on the mere availability of the services. City of Glendale v. Trondsen, 48 Cal. 2d 93, 308 P.2d 1 (1957) (but see discussion concerning proportionality below). An excise tax generally is levied against an activity which can be foregone without loss of ownership; most parcel taxes imposed as excise taxes do not bear this characteristic. City of Oakland v. Digre, 205 Cal. App. 3d 99, 252 Cal. Rptr. 99 (1988).

ii) PROPORTIONALITY. Generally a tax is for revenue rather than regulatory purposes and need not bear any relation to the benefit conferred upon the taxpayer or the burden placed on the public by the taxpayer. See, e.g., Trent Meredith, Inc. v. City of Oxnard, 114 Cal. App. 3d 317, 327, 170 Cal. Rptr. 685 (1981). The requirement that a parcel tax must be "proportional" to the use of city services was raised in City of Oakland v. Digre, 205 Cal. App. 3d 99, 252 Cal. Rptr. 99 (1988). Some municipal parcel taxes for city services have a broad scope which does not necessarily provide a direct link between the taxpayer and the use of the city service. Such a parcel tax is distinguishable from other types of excise taxes which are imposed at the time of use for the privilege of using a specific service. See, e.g., Douglas Aircraft Co., Inc. v. Johnson, 13 Cal. 2d 545, 90 P.2d 572 (1939); Ingels v. Riley, 5 Cal. 2d 154, 53 P.2d 939 (1936); City of Glendale v. Trondsen, 48 Cal. 2d 93, 308 P.2d 1 (1957). The "proportionality" requirement of Digre seems to derive from the "apportionment requirement" discussed at section VIIA.2.a.(5)(e) of this handbook. Apportionment requires a tax to be based on a measure which reflects the proportion of the taxed activity which is actually carried on within the taxing jurisdiction. Proportionality requires a taxing scheme which differentiates between users of property on some "rational basis". City of Oakland v. Digre, 205 Cal. App. 3d 99, 252 Cal. Rptr. 99, at footnote 3 (1988).

iii) BASES FOR DISTINGUISHING DIGRE. Possible bases for distinguishing Digre from other cases are: (1) Digre merely held proportionality is relevant to whether a tax is an excise tax on municipal services, not whether the tax is valid; (2) Digre held proportionality is one of several factors to be reviewed (see discussion under section VII.A.2.a.(8) of this handbook for other factors), but did not hold proportionality alone is determinative; (3) Oakland stated its tax was based on use of municipal services rather than availability, so Glendale may be distinguishable; and (4) proportionality may be relevant when the tax is based on the use of services themselves, but is irrelevant when the tax has some other basis such as use of the parcel. See also the discussion of poll taxes, below.

(10) POLL TAX

(a) DEFINITION. . A poll tax is a flat rate tax imposed directly upon all persons, or all persons within a particular class. A poll tax is sometimes known as a "head" tax or a "capitation" tax. While the term "poll tax" conjures up images of racism, it was the racially-motivated use of requirements to pay poll taxes as a prerequisite to vote which was improper and subsequently prohibited by the 24th Amendment.

(b) VALIDITY. While it is unclear whether any cities currently impose a poll tax, such a tax would presumably be valid. See generally Marquis v. City of Santa Ana, 103 Cal. 661, 37 P. 650 (1894); City and County of San Francisco v. Collins, 216 Cal. 187, 13 P.2d 912 (1932); Cal. Const. art. XII, § 12 (at one time prohibited poll taxes and later limited them to $4, but currently does not refer to poll taxes). Accordingly, a parcel tax in the nature of a poll tax could be imposed, with the rate based upon the number of occupants of a parcel.

PRACTICE TIPS: Due to the questionable validity of parcel taxes in the nature of property taxes, it is certainly preferable to adopt a parcel tax as an excise tax. The following strategies will help ensure a parcel tax is considered an excise tax rather than a property tax:

1. *State explicitly in the ordinance the tax is an excise tax for revenue raising purposes and specify what activity or privilege the tax is based upon.*

2. *Articulate the tax is on use of the property rather than ownership.*

3. *Specify the tax is a personal debt--not a lien on the property; do not have the tax collected as an item on the property tax bill. Consider collecting the tax as an item on water, sewer or garbage bills for ease of collection.*

4. *It is preferable to have the tax imposed upon the occupant of property rather than the owner.*

5. *It is preferable if the tax is not imposed on vacant parcels.*

6. *If the tax is based on the use of municipal services or facilities, adopt a rate schedule which makes the tax roughly proportional to the probable use of such services or facilities by each class of property.*

7. *If possible, collect the tax whenever the privilege being taxed is exercised rather than at regular time periods.*

8. *Alternatively, if a poll tax is imposed, give the tax a name with fewer negative connotations, such as a per capita tax or a head tax.*

9. *Consider using one of the constitutional or statutory authorities for imposing a special tax subject to the two-thirds vote requirement.*

Depending upon the use to which the funds are to be put, consider using the 1972 Landscaping and Lighting District Act or some other assessment district basis.

(11) TRANSFER TAX

(a) DOCUMENTARY TRANSFER TAX. The Documentary Transfer Tax Act authorizes a city, within a county which has imposed a tax pursuant to the provisions of the act, by ordinance to impose a documentary transfer tax at half the county rate. See Cal. Rev. & Tax. Code §§ 11911(a), (c).

(b) DEFINITION. A documentary transfer tax is an excise tax imposed on the transfer of interests in real estate. The tax is in proportion to the consideration or value of the property or interest conveyed (exclusive of liens and encumbrances) and apply unless such consideration exceeds one hundred dollars. Cal. Rev. & Tax. Code § 11911(a).

(c) TAX RATE. A city is allowed to impose a tax of one-half of the county tax rate of fifty-five cents for each five hundred dollars or fraction thereof of the consideration or value. Cal. Rev. & Tax. Code § 11911(a).

(d) CITY TAX CREDITS. The amount of tax paid pursuant to a city documentary transfer tax ordinance is a credit against the county tax due, but only if the city tax is in conformity with state law. Cal. Rev. & Tax. Code §§ 11911(c), 11931.

(e) EXEMPTION. The Documentary Transfer Tax Act exempts from tax any instruments from which an exempt governmental agency has acquired title. There are a number of other statutory exemptions dealing with reorganizations, partnerships, orders of the Securities and Exchange Commission, transfers between spouses, and debt instruments. Cal. Rev. & Tax. Code §§ 11921 - 11929.

(f) REAL PROPERTY TRANSFER TAXES. Some charter cities have enacted a real property transfer tax which imposes a tax on the purchaser of real property based upon the value of the property. Courts have determined that such a tax, enacted by a charter city, does not violate either article XIIIA of the California Constitution (Cohn v. City of Oakland, 223 Cal. App. 3d 261, 272 Cal. Rptr. 714 (1990)); or Government Code section 53725, which prohibits a transaction tax on the sale of real property (Fielder v. City of Los Angeles, 14 Cal. App. 4th 137, 17 Cal. Rptr. 2d 630 (1993)). Although California Government Code section 37100.5 gives a general law city the authority to impose the same type of taxes that a charter city imposes, a general law city is subject to the restrictions of both article XIIIA, section 4 of the California Constitution and Government Code section 53725, which specifically prohibit a transaction tax on the sale of real property. Although the validity of Government Code section 53725 has not yet been determined, the California Supreme Court has held the voter-approval provisions of Proposition 62 to be valid. See Santa Clara County Local Transportation Authority v. Guardino, 11 Cal. 4th 220, 45 Cal. Rptr. 2d 207 (1995).

b. SPECIAL TAXES

(1) INTRODUCTION

Cities "by a two-thirds vote of the qualified electors . . . may impose special taxes." Cal. Const. art. XIIIA, § 4; Cal. Const. art. XIIIC, § 2(d). This provision has been construed not as a grant of authority to impose special taxes but as a restriction on the power to do so. County of Fresno v. Malmstrom, 94 Cal. App. 3d 974, 156 Cal. Rptr. 777 (1979). California Government Code section 50075, however, gives cities the power to impose special taxes, subject to the constitution's two-thirds vote requirement. Section 4's restriction on local taxes was deemed necessary to assure effective property tax relief. Amador Valley Joint Union High School Dist. v. State Board of Equalization, 22 Cal. 3d 208, 149 Cal. Rptr. 239 (1978). The imposition of special taxes is also subject to the requirements of Propositions 62 and 218. See discussion at section VII.A.2.c.5-6 of this handbook.

(2) DEFINITION

(a) LABEL. The label given to a charge is not dispositive; rather, in case of a dispute, a court will look to the charge's purpose and effect. Mills v. County of Trinity, 108 Cal. App. 3d 656, 661, 166 Cal. Rptr. 674 (1980); City of Oakland v. Digre, 205 Cal. App. 3d 99, 105, 252 Cal. Rptr. 99, 101 (1988).

(b) SPECIAL PURPOSE. A "special tax" is "special," that is, it is "collected and earmarked for a special purpose, rather than being deposited in a general fund." Cal. Gov't Code § 53721; City and County of San Francisco v. Farrell, 32 Cal. 3d 47, 53, 184 Cal. Rptr. 713 (1982). The mere reference to one possible use of general tax proceeds for a specific municipal purpose (police and fire) does not necessarily transform a general tax into a special tax. Fenton v. City of Delano, 162 Cal. App. 3d 400, 208 Cal. Rptr. 486 (1984). When faced with a special district formed after the adoption of Proposition 13 which was putting the proceeds of a tax for its one and only special purpose into its general fund in Rider v. County of San Diego, 1 Cal. 4th 1, 2 Cal. Rptr. 2d 490 (1991), however, the California Supreme Court revised this definition. The court said: "A more reasonable interpretation of section 4, consistent with Farrell's [citation] guidelines is that a 'special tax' is one levied to fund a specific governmental project or program." The court observed "every tax levied by a 'special purpose' district or agency would be deemed a 'special tax.'" Id. at 15. The Rider court established a new test, the essential control test, to determine if a local agency was created to circumvent the property tax limitations of article XIIIA: If the new local agency is essentially controlled by one or more cities or counties that would have to comply with the voter approval requirement, it will be deemed the agency was created to circumvent Proposition 13 and its taxes are special taxes. Additionally, with the passage of Proposition 218 in 1996, a new definition of special tax was added to the constitution. Cal. Const. art. XIIIC, § 1(d). This definition provides that a special tax means "any tax imposed for specific purposes, which is placed into a general fund." Thus, placement of a tax into the general fund of a city appears to no longer definitively assure that the tax will not be characterized as a special tax. Cal. Const. art. XIIIC, § 1(d). In Coleman v. County of Santa Clara, 64 Cal. App. 4th 662, 75 Cal. Rptr. 2d 516 (1998), the 6th District Court of Appeals applied a two-part test for identification of a "special tax": (1) is the entity which imposes the tax a general-purpose entity (like a City) or a special-purpose entity, which can impose only special taxes by its very nature; (2) if the tax is imposed by a general-purpose entity, are the proceeds "legally obligated" for a "special purpose."

(c) TAX VERSUS OTHER KIND OF CITY CHARGES. A "special tax" is a "tax."

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i) FEES DISTINGUISHED. Any charge imposed by a city, however labeled, could be characterized as a "tax" for some purposes, but for the purpose of determining whether a two-thirds vote is required, the term "tax" does not include a charge "which does not exceed the reasonable cost of providing the service or regulatory activity for which the fee is charged and which is not levied for general revenue purposes." See Cal. Gov't Code § 50076. The term "special taxes" does not include "regulatory fees" which are "reasonably commensurate with the cost of regulatory activity from those at whose instance the activity is conducted." Mills v. Country of Trinity, 108 Cal. App. 3d 656, 663, 166 Cal. Rptr. 674 (1980). It does not matter if a fee does not benefit those charged as long as the fee is commensurate with the burden imposed by the activity of those charged. Sinclair Paint Co. v. State Board of Equalization, 15 Cal. 4th 866, 64 Cal. Rptr. 2d 447 (1997) (approving fees assessed on persons contributing to environmental lead contamination to administer the Childhood Lead Poisoning Prevention Act). Pennell v. City of San Jose, 42 Cal. 3d 365, 375, 228 Cal. Rptr. 726 (1986) (approving a charge imposed on landlords to administer a city's rent control ordinance).

ii) ASSESSMENTS DISTINGUISHED. A special tax does not include a special assessment. Knox v. City of Orland, 4 Cal. 4th 132, 14 Cal. Rptr. 2d 159 (1992). See discussion of special assessments in section VII.A.3.a. of this handbook.

(d) MAKING A RECORD. In case of a challenge to a charge imposed by a city without two-thirds voter approval, the burden will be on the city to demonstrate the charge is either a fee or a general tax. Thus, before imposing a charge which is not going to be submitted to a vote, a city must make a record establishing "(1) the estimated costs of the service or regulatory activity, and (2) the basis for determining the manner in which the costs are apportioned, so that charges allocated to a payor bear a fair or reasonable relationship to the payors' burdens on or benefits from the regulatory activity." San Diego Gas & Electric Company v. San Diego County Air Pollution Control District, 203 Cal. App. 3d 1132, 1146, 250 Cal. Rptr. 420, 429 (1988); Beaumont Investors v. Beaumont-Cherry Valley Water District, 165 Cal. App. 3d 227, 235-236, 211 Cal. Rptr. 567 (1985).

PRACTICE TIPS:

1. While the label given to a charge is not dispositive, a city should not label a fee or a charge as a tax. The imposition of the charge or fee should be supported by evidence showing the revenues raised will not exceed the cost of providing the service or regulation. Follow statutory authority for levy of a particular fee or charge.

2. The two-thirds voter approval requirement for a tax may be avoided if revenue from a tax is placed in a city's general fund. However, if it is clear the tax is really for a particular purpose, it may be considered a special tax under Rider and Proposition 218, Cal. Const. art. XIIIC § 2(d), even if revenue is placed in the general fund. Thus, if the intention of a charge, as opposed to a tax, is to fund a "specific project or program," the record should show the charge is "reasonably commensurate" with the cost of a regulatory activity or services being provided. Such a record may establish a charge is a fee rather than a tax.

(3) MELLO-ROOS COMMUNITY FACILITIES ACT

(a) IN GENERAL. The Mello-Roos Community Facilities Act of 1982 (Mello-Roos) provides a method of financing public facilities, infrastructure and services in connection with new development. See generally Cal. Gov't Code §§ 53311 et seq. Mello-Roos provides certain local agencies (including cities) with authority to form Mello-Roos districts to finance a wide range of public facilities and services through imposition of special taxes approved by a two-thirds vote of the qualified electorate of the district.

(b) VOTE. The vote is either by registered voters or by landowners, depending upon whether there are twelve or more registered voters within the proposed district before formation. Mail ballots are authorized. Once established, a Mello-Roos district is a legally constituted governmental entity distinct from the local agency that created it even though the members of the local agency and the district are the same.

(c) FACILITIES FINANCED. A Mello-Roos district may be used to finance the purchase, construction, improvement, expansion or rehabilitation of any real or tangible property with an estimated useful life of five or more years. Authorized facilities include:

i) park, recreation and open space facilities;

ii) school sites and buildings;

iii) libraries;

iv) child care facilities;

v) water transmission and distribution facilities;

vi) natural gas pipeline facilities;

vii) telephone, electrical and cable television facilities; and

viii) any other governmental facilities which the legislative body creating the district is authorized to contribute revenue to, construct, own or operate.

In addition, a Mello-Roos district may pay for work necessary to bring buildings (including privately-owned buildings) into compliance with seismic safety standards or regulations.

(d) SERVICES FINANCED. Subject to certain restrictions, a Mello-Roos district may also finance a number of services, including:

i) police protection services, including the provision of services for jail or other detention facilities;

ii) fire protection services;

iii) ambulance and paramedic services;

iv) flood and storm protection services;

v) removal or remedial action for the clean-up of any hazardous substance released or threatened to be released into the environment; and

vi) recreation program services, library services and the operation and maintenance of parks, open space, museums and cultural facilities.

(e) FORMATION OF A MELLO-ROOS DISTRICT. The formation of a Mello-Roos district includes a number of procedural steps set forth by statute. After formation of the district, the special tax is voted on by the qualified electors of the district. The qualified electors are either land owners or registered voters depending on statutory requirements. Cal. Gov't Code §§ 53315 et seq.

(f) LEVYING THE TAX. The special tax is levied by ordinance once and can be adjusted annually by resolution. There is some flexibility in designing the special tax formula. The tax must be apportioned in a fair and reasonable manner, although it cannot be an ad valorem tax. Unlike a special assessment, the Mello-Roos special tax need not be apportioned on the basis of any benefit to property although it may be apportioned based upon benefit. Upon approval of this special tax by the voters, the legislative body may levy the tax in any amount up to the rate authorized in the resolution of formation. Cal. Gov't Code § 53340.

(g) COLLECTION. Once levied, the special tax is collected twice a year along with the property tax. The special tax is subject to the same penalties, foreclosure procedures and sale and lien priorities in the event of delinquency as ad valorem property taxes. Cal. Gov't Code § 53340. Alternatively, the special tax may be collected off of the property tax bill, such as by direct billing of the property owners.

(h) EXEMPTIONS. Properties or entities of the state, federal or other local governments are exempt from the special tax unless such entity acquires the property not otherwise exempt. Cal. Gov't Code § 53340.1.

(i) CHANGES TO DISTRICT. After establishment of the district and approval of the special tax, new facilities or services may be added, or the maximum special tax increased or decreased. Any such changes require procedure similar to formation, including adoption of an initial resolution, notice to landowners or residents, a public hearing, a vote by the legislative body to put the issue on the ballot, and an election with two-thirds voter approval required. Within fifteen days after approval of this special tax by the voters, the district must record a notice of special tax lien with the county recorder. From the date of recordation, all persons are deemed to have notice of the tax lien.

(j) BONDS. Mello-Roos bonds are of the same force, value and use as bonds issued by any municipality and interest on such bonds is exempt from state tax. Generally such bonds would be exempt from federal tax.

PRACTICE TIPS: Mello-Roos allows for flexibility in both the facilities which may be financed and how the burden or costs are to be spread. It also requires the cooperation of both landowners and a city. If, for example, the city council does not approve the proposed community services district, the city will not conduct the proceedings. At the same time, if the landowners do not agree to the proposed community services district, they will not vote for it. Consequently, before proceedings take place, there are typically negotiations that take place between city staff and property owners. Because of the two-thirds vote requirement, Mello-Roos is generally available to large undeveloped parcels with less than twelve registered voters. Mello-Roos districts do have the potential for creating issues following formation as one group of citizens pays more taxes compared to landowners outside the district. In addition, if the real estate economy changes significantly after the formation of the district, the security provided by real property, if any, can be diminished. Some experts counsel retention of specialists whenever creating a Mello-Roos district because the design of the special tax formula is so critical to the validity of the district and its special tax.

(4) POLICE AND FIRE PROTECTION

(a) IN GENERAL. Any local agency which provides fire or police services can propose by ordinance the levy of a special tax other than an ad valorem property tax if the ordinance imposing such tax is adopted by the legislative body and approved by two-thirds of the voters voting on the proposition. Cal. Const. art. XIIIC, § 2(d); Cal. Gov't Code §§ 53970, 53978.

(b) IMPLEMENTING ORDINANCE.

i) MANDATORY PROVISIONS. The special tax must be levied on "a parcel, class of improvement to property, or use of property basis, or a combination thereof" to which specific fire protection or prevention services or police protection services are made available. Cal. Gov't Code § 53978(b). The ordinance submitted for voter approval must specify the amount of each such special tax or the maximum amount that can be annually levied. Cal. Gov't Code § 53978(b).

ii) OPTIONAL PROVISIONS. The amount of each special tax may be varied to each parcel, improvement or use based on the availability of police and fire services in the area. Cal. Gov't Code § 53978(c). A question exists as to whether or not levying a tax solely on a parcel basis would result in a flat rate which might run afoul of the United States and the California Constitutions. See U.S. Const. amend. XIV (equal protection clause); City of San Jose v. Donohue, 51 Cal. App. 3d 40, 123 Cal. Rptr. 804 (1975); Cal. Const. art. I, § 7. The legislative body can provide the special tax be collected in the same manner and subject to the same penalties as taxes collected by or on behalf of the agency. If the county collects the tax, it may deduct its reasonable costs. Cal. Gov't Code § 53978(d).

(c) IMPACT ON OTHER METHODS OF FUNDING POLICE AND FIRE SERVICES. A general tax does not become a special tax under California Government Code section 53978 merely because some of its proceeds will be used for police and fire services. Fenton v. City of Delano, 162 Cal. App. 3d 400, 208 Cal. Rptr. 486 (1984). But see Cal. Const. art. XIIIC, § 1(d).

(5) LIBRARIES

(a) IN GENERAL. A city, county, city or county and library district may impose a special tax for the purpose of providing library facilities and services described in California Education Code sections 18010 et seq. Cal. Gov't Code § 53717.

(b) TAX NOT ASSESSMENT. Since this is a special tax and not a special assessment, there is no requirement that the tax be apportioned on the basis of benefit to any property. If a library tax is based on benefit received by parcels of real property, the special tax will not be construed to be a property tax. Cal. Gov't Code § 53717.2.

c. LIMITATIONS ON EXERCISE OF TAXING AUTHORITY

(1) EQUAL PROTECTION AND DUE PROCESS

(a) IN GENERAL. The courts have established principles for review of tax statutes and ordinances when the constitutional challenge is based on the equal protection and/or the due process clause. City of San Jose v. Donohue, 51 Cal. App. 3d 40, 123 Cal. Rptr. 804 (1975).

(b) UNIFORMITY. Absolute uniformity or equality in the application of tax measures can never be obtained. Willingham Bus Lines, Inc. v. Municipal Court for the San Diego Judicial District of San Diego County, 66 Cal. 2d 893, 59 Cal. Rptr. 618 (1967).

(c) RATIONAL BASIS. A tax statute or ordinance which distinguishes between parties does not violate the equal protection or due process clause if the distinction rests on a rational basis. It must be presumed to rest on that basis if there is any conceivable state of facts which would support it. Ladd v. State Board of Equalization, 31 Cal. App. 3d 35, 106 Cal. Rptr. 885 (1973). Administrative convenience and expense in the collection or measurement of a tax are alone sufficient justification for treating some taxpayers differently than others. Carmichael v. Southern Coal Company, 301 U.S 495, 57 S. Ct. 868 (1937).

(d) DUE PROCESS. "It may be stated as a general rule that the due process clause of the federal constitution, Amend. 14, is satisfied in matters of taxation if, at some stage before a tax becomes irrevocably fixed the taxpayer is given the right, of which he shall have notice, to contest the validity or amount of the tax before a board or tribunal provided for that purpose." California v. Sonleitner, 185 Cal. App. 2d 350, 356-357, 8 Cal. Rptr. 528 (1960).

(2) FIRST AMENDMENT–FREE SPEECH

(a) NON-DISCRIMINATION. Cities have the power to license for the purpose of generating revenue. This includes the taxation of First Amendment activities. However, those engaged in protected speech may not be singled out for discriminatory treatment in the absence of counterbalancing governmental interests of compelling importance that cannot be achieved without differential taxation. Minneapolis Star and Tribune Company v. Minnesota Commissioner of Revenue, 460 U.S. 575, 103 S. Ct. 1365, 75 L. Ed. 295 (1983); Times Mirror Company v. City of Los Angeles, 192 Cal. App. 3d 170, 237 Cal. Rptr. 346 (1987).

(b) PERMISSIBLE CLASSIFICATIONS. The entertainment industry may be properly subdivided and separately classified if the classification is founded on natural, intrinsic, or fundamental distinctions which are reasonably related to the object of the legislation. Times Mirror Company v. City of Los Angeles, 192 Cal. App. 3d 170, 237 Cal. Rptr. 346 (1987).

(c) OTHER HANDBOOK REFERENCE. For related material, please see the following section of this handbook:

i) V.F.: Police Power, First Amendment.

(3) PROPOSITION 13

(a) IN GENERAL. Proposition 13, article XIIIA of the California Constitution, limits cities' ability to tax in two ways. Article XIIIA, section 4 prevents cities from levying special taxes without two-thirds voter approval. Sections 1 and 4 of article XIIIA prevent cities from levying certain taxes on real property even with two-thirds voter approval. (Section 1 says any ad valorem tax on real property is limited to one percent of assessed valuation and may be levied only by counties; section 4 provides cities may impose special taxes, with the exception of ad valorem taxes on real property or transaction or sales taxes on the sale of real property, with two-thirds voter approval.)

(b) CONSTITUTIONALITY. Proposition 13's methods for assessing property taxes have been upheld against constitutional attacks. See Nordlinger v. Hahn, 505 U.S. 1, 112 S. Ct. 2326, 120 L. Ed. 2d 1 (1992) (rejecting an equal protection challenge); Amador Valley Joint Union High School District v. State Board of Equalization, 22 Cal. 3d 208, 149 Cal. Rptr. 239 (1978).

(c) SPECIAL TAXES. The limits on taxes placed by section 4 of article XIIIA apply only to special taxes. See City and County of San Francisco v. Farrell, 32 Cal. 3d 47, 184 Cal. Rptr. 713 (1982); Cohn v. City of Oakland, 223 Cal. App. 3d 261, 263, 272 Cal. Rptr. 714 (1990) (upholding Oakland's increase in the real property transfer tax because revenue was placed in general fund and was thus a "general tax"); Coleman v. County of Santa Clara, 64 Cal. App. 4th 662, 75 Cal. Rptr. 2d 516 (1998) (upholding a sales tax increase for general government purposes on the same ballot as an advisory measure stating the voters' preference for use of the sales tax increase). See also Rider v. County of San Diego, 1 Cal. 4th 1, 2 Cal. Rptr. 2d 490 (1991).

(d) OTHER REFERENCES. On making a record to establish a charge is not a special tax, please see section VII.A.2.b. of this handbook. On making a record to establish a tax is a parcel-excise tax and not an invalid ad valorem property tax, please see section VII.A.2.a.(2) of this handbook.

(4) TAX EXEMPTIONS

(a) PROPERTY. Some kinds of property are exempt from taxation. These include property owned by the state, see Cal. Const. art XIII, § 3(a), most property owned by local government, see Cal. Const. art XIII, §§ 3(b), 11, libraries and museums, see Cal. Const. art XIII, § 3(d), property used for certain kinds of schools, see Cal. Const. art XIII, §§ 3(d), (e), churches, see Cal. Const. art XIII, § 3(f), and certain federal instrumentalities, see, e.g., 12 U.S.C. §§ 531 (Federal Reserve Bank), 1768 (federal credit unions), 1825 (Federal Deposit Insurance Corporation). An excise tax imposed on an entity which is exempt from property taxes may be seen as an unconstitutional tax. Sacramento Municipal Utility Dist. v. County of Solano, 54 Cal. App. 4th 1163, 63 Cal. Rptr. 2d 286 (1997).

(b) INSURANCE COMPANIES. Insurance companies are subject to a tax set by the California Constitution; this tax is in lieu of all other taxes, even those which are not on insurance premiums. Cal. Const. art. XIII, § 28; Mutual Life Insurance Company of New York v. City of Los Angeles, 50 Cal. 3d 402, 267 Cal. Rptr. 589 (1990) (finding insurance companies have a broad exemption from state and local taxes, except for property taxes, motor vehicle taxes and fees).

(c) BANKS. Banks are subject to a tax by the state which is in lieu of all other taxes. See Cal. Const. art. XIII, § 27; Cal. Rev. & Tax Code §§ 23001 et seq.

(d) FINANCIAL CORPORATIONS (SAVINGS AND LOANS). Certain other financial institutions are also subject to a state tax which is in lieu of all other taxes, even charter city taxes. Cal. Rev. & Tax. Code § 23182; California Federal Savings and Loan Assn. v. City of Los Angeles, 54 Cal. 3d 1, 283 Cal. Rptr. 569 (1991).

(5) PROPOSITION 62

(a) IN GENERAL. Proposition 62 is a statewide statutory initiative that amended parts of the California Government Code. See Cal. Gov't Code §§ 53720 et seq. Proposition 62 purportedly applies to counties, cities, cities and counties, (including charter cities), any public or municipal corporation and special districts. Cal. Gov't Code § 53720. Several appellate court decisions have indicated that certain portions of Proposition 62 do not apply to charter cities. See Fielder v. City of Los Angeles, 14 Cal. App. 4th 137, 17 Cal. Rptr. 2d 630 (1993).

(b) PROCEDURES FOR ENACTING TAXES. Proposition 62 requires taxes to be proposed by ordinance or resolution. The ordinance or resolution must include the type of tax, the rate of tax, and the method of collection and, if a special tax, the purpose for which its imposition is sought. Cal. Gov't Code § 53724(a). See section VII.A.C.5.iii.(c) (below) of this handbook for a discussion of the effect of constitutional challenges on these procedural requirements.

i) GENERAL TAXES. Enactment of general taxes requires a two-thirds vote of the legislative body, see Cal. Gov't Code § 53724(b), and a majority vote of voters voting in an election on the tax. Cal. Gov't Code § 53723. Santa Clara County Local Transportation Authority v. Guardino, 11 Cal. 4th 220, 45 Cal. Rptr. 2d 207 (1995) (finding Proposition 62's voter-approval requirement for general and special taxes constitutional and disapproving City of Woodlake v. Logan, 230 Cal. App. 3d 1058, 282 Cal. Rptr. 27 (1991)). The election to approve a general tax must be consolidated with a regularly-scheduled general election for members of the governing body of the local government, except in cases of emergency declared by unanimous vote of the governing body. Cal. Const. art. XIIIC, § 2(b).

ii) SPECIAL TAXES. Enactment of special taxes requires a two-thirds vote of voters voting in an election on the tax. Cal. Gov't Code § 53722. Santa Clara County Local Transportation Authority v. Guardino, 11 Cal. 4th 220, 45 Cal. Rptr. 2d 207 (1995) (finding the voter-approval requirements for Proposition 62 valid). See also Cal. Const. art. XIIIA, § 4, Cal. Const. art. XIIIC, § 2(d) (also imposing a two-thirds voter approval requirement for special taxes). Ordinances or resolutions enacting special taxes must include the purpose or service for which the tax is imposed. Cal. Gov't Code § 53724(a). The revenues for special taxes may only be used from these purposes. Cal. Gov't Code § 53724(e).

iii) CONSTITUTIONAL CHALLENGES TO GENERAL TAX VOTER-APPROVAL REQUIREMENTS. Article II, section 9 of the California Constitution states the electorate's power of referendum does not extend to tax levies. But see Santa Clara County Local Transportation Authority v. Guardino, 11 Cal. 4th 220, 45 Cal. Rptr. 2d 207 (1995) (finding that the voter-approval requirements of Proposition 62 are not substantially equivalent to a referendum). See section VII.A.2.c.6.(a)-(e) of this handbook (below) for a discussion of Proposition 218 which provides that, notwithstanding article II, section 9, the initiative power may be used to reduce or repeal any local tax.

a) "WINDOW PERIOD" TAXES. Proposition 62 required a vote on taxes enacted between August 1, 1985 and November 4, 1986 (the so-called "window period" before Proposition 62 was enacted). See Cal. Gov't Code § 53727(b). The "window period" voter-approval requirement has been held unconstitutional. City of Westminster v. County of Orange, 204 Cal. App. 3d 623, 251 Cal. Rptr. 511 (1988), rev. denied (December 15, 1988). The California Supreme Court distinguished Westminster in finding that the voter-approval requirements of Proposition 62 are valid. But see Santa Clara County Local Transportation Authority v. Guardino, 11 Cal. 4th 220, 45 Cal. Rptr. 2d 207 (1995). See section VII.A.2.c.6.(a)-(e) of this handbook (below) for a discussion of Proposition 218.

b) TAXES ENACTED AFTER PROPOSITION 62'S PASSAGE. A court of appeal held Proposition 62's voter-approval requirement for general taxes to be an unconstitutional referendum under article II, sections 9 and 11 of the California Constitution. City of Woodlake v. Logan, 230 Cal. App. 3d 1058, 282 Cal. Rptr. 27 (1991), rev. denied (1992). The issue was not addressed conclusively by the California Supreme Court until 1995. See Santa Clara County Local Transportation Authority v. Guardino, 11 Cal. 4th 220, 45 Cal. Rptr. 2d 207 (1995) (finding the voter-approval requirements of Proposition 62 valid) disapproving City of Woodlake v. Logan, 230 Cal. App. 3d 1058, 282 Cal. Rptr. 21 (1991). One of the most critical issues left undecided by Guardino is whether the supreme court's ruling that the voter-approval requirements of Proposition 62 are valid will be applied retroactively to taxes adopted after November 4, 1986 (the effective date of Proposition 62). This issue was initially decided in McBrearty v. City of Brawley, 59 Cal. App. 4th 1441, 69 Cal. Rptr. 2d 862 (1997), which held that the three year statute of limitations for challenging tax measures began anew when the California Supreme Court decided Guardino; City of Brawley must place on the ballot its utility users tax adopted subsequent to City of Woodlake v. Logan (holding Proposition 62 unconstitutional) but prior to January 1, 1995 (the beginning of the Proposition 218 window period). See section VII.A.2.c.6.(a)-(e) (below) of this handbook for a discussion of Proposition 218. In 2001, however, the California Supreme Court overruled the McBrearty decision insofar as a claim would begin anew after Guardino. See Howard Jarvis Taxpayers Assn. v. La Habra, 25 Cal. 4th 809, 817, 107 Cal. Rptr. 2d 369 (2001). Instead, in a unanimous decision, the Court in La Habra held that the applicable statute of limitations for challenging tax measures begins anew each time the tax is collected. La Habra, 25 Cal. 4th at 825.

(c) RESTRICTION ON REAL PROPERTY TRANSACTION SALES TAXES. Proposition 62 prohibits local transaction taxes or sales taxes on the sale of real property within the city, county or district. Cal. Gov't Code § 53725. A variation on this restriction is also contained in Proposition 13, see Cal. Const. art. XIIIA, § 4, however that section applies only to special taxes. See City and County of San Francisco v. Farrell, 32 Cal. 3d 47, 184 Cal. Rptr. 713 (1982). Although the constitutionality of this part of Proposition 62 has not been resolved, the California Supreme Court has recently validated the voter-approval sections of Proposition 62. See Santa Clara County Local Transportation Authority v. Guardino, 22 Cal. 4th 220, 45 Cal. Rptr. 2d 207 (1995). See Fielder v. City of Los Angeles, 14 Cal. App. 4th 137, 17 Cal. Rptr. 2d 630 (1993) (finding this part of Proposition 62 does not apply to charter cities). See section VII.A.2.c.6.(a)-(e) (below) of this handbook for a discussion of Proposition 218 specifically applying certain voting requirements to the adoption of general taxes by charter cities.

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(d) REDUCTION IN PROPERTY TAX ALLOCATIONS FOR FAILURE TO COMPLY WITH PROPOSITION 62. Proposition 62 states that if any local government or district imposes any tax without complying with Proposition 62, its property tax revenue allocation must be reduced one dollar for each dollar attributable to such tax. Cal. Gov't Code § 53728. This provision was found to be unconstitutional in City of Woodlake v. Logan, 230 Cal. App. 3d 1058, 282 Cal. Rptr. 27 (1991). However, Woodlake has been disapproved by the California Supreme Court implying that California Government Code section 53728 may be constitutional. See Santa Clara County Local Transportation Authority v. Guardino, 11 Cal. 4th 220, 45 Cal. Rptr. 2d 207 (1995).

(e) REFUND PROCEDURES IN PROPOSITION 62 CHALLENGES. Although the California Supreme Court in Howard Jarvis Taxpayers Assn. v. La Habra, 25 Cal. 4th 809, 107 Cal. Rptr. 2d 369 (2001), found that the plaintiffs had abandoned their claim for a refund of taxes paid, it nevertheless explained that a city may specify the period within which a claim may be filed. Absent any claims period in a city ordinance, the three-year period under Code of Civil Procedure section 338(a) for liabilities created by statute likely applies. The refund procedures adopted by a city may not, however, require the utility service provider to secure the refund and then refund or credit the utility customer. Such a procedure, the La Habra Court explained, would violate Public Utilities Code section 799, providing that service suppliers have no duty to investigate the validity of a utility tax, are not liable to customers for refunds and have no duty to pay refunds if the local jurisdiction is ordered to refund taxes paid. La Habra, 25 Cal. 4th at 820, n. 3.

PRACTICE TIP: To limit the potential exposure to refund claims, a city may wish to adopt the minimum one year claims limitation period through the procedure authorized under the Tort Claims Act. See Government Code § 935.

(6) PROPOSITION 218

(a) IN GENERAL. Proposition 218 is a statewide initiative which adds articles XIIIC and XIIID to the California Constitution and makes numerous changes to local government finance law, particularly in the areas of taxes and fees and assessments. See section VII.A.3.d. and VII.A.6.g. of this handbook for discussion of the effect of Proposition 218 on fees and assessments. Proposition 218 applies to counties, cities, cities and counties (including charter cities), any public or municipal corporation and special districts. On July 1, 1997, the Proposition 218 Omnibus Implementation Act was signed into law as an urgency statute. This act offers clarifications to the provisions of Proposition 218 and is to be liberally construed so as to effectuate the purposes of limiting local government revenue and enhancing taxpayer consent. This act amends Elections Code section 4000, Government Code section 54954.6, Streets and Highways Code section 9525, and adds sections 53739, 53750, 53753, and 53753.5 to the Government Code. Unfortunately, despite its "omnibus" title, the principal effect of the act was to clarify only Proposition 218's impact on approval processes for special assessments and it did not provide guidance to many other provisions of Proposition 218, such as property-related fees and charges.

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PRACTICE TIP: The League of California Cities has published an implementation guide on Proposition 218 (2000 edition). Copies of the guide are available through the League. For more information contact the League's publication unit at 1400 K Street, 4th Floor, Sacramento, CA 95814, 916/658-8253, FAX 916/658-8240.

(b) NEW DEFINITIONS OF "GENERAL" AND "SPECIAL" TAXES. Proposition 218 defines a "general tax" as any tax imposed for general governmental purposes. See Cal. Const. art. XIIIC, § 1(a). Proposition 218 defines "special tax" as any tax imposed for specific purposes including taxes imposed for specific purposes and placed into a general fund. See Cal. Const. art. XIIIC, § 1(d).

PRACTICE TIP: Even though Proposition 218 defines the terms "assessments" and "fees and charges," it does not define the word "tax." Therefore, look to previously existing law to determine the difference between a tax or a fee or an assessment.

(c) TAXES ENACTED PRIOR TO PROPOSITION 218'S PASSAGE. Proposition 218 requires any general tax imposed, extended or increased between January 1, 1995 and November 6, 1996 without voter approval must be submitted to the voters within two years in order to continue imposing the general tax. Cal. Const. art. XIIIC, § 2(c). The election for these "window period" taxes is subject to all the restrictions described below relating to general taxes. Cal. Const. art. XIIIC, § 2(c).

PRACTICE TIP: As a practical matter, the election for the "window period" taxes must have occurred by the November 3, 1998 general election. See Cal. Elec. Code § 324(a)(1).

The language of Proposition 218 is unclear as to whether only that portion of a tax which is increased or extended must be submitted to the voters or the entire tax, including the increase or extension. A reasonable interpretation would limit the election only to the increase or extension, but a future court may determine otherwise.

(d) PROCEDURES FOR ENACTING NEW OR INCREASED TAXES.

i) GENERAL TAXES. No local government may impose, extend or increase any general tax until such tax is submitted to the electorate and approved by a majority of the electorate voting on the tax. Cal. Const. art. XIIIC, § 2(b). The election to approve a general tax must be consolidated with a regularly-scheduled general election for members of the governing body of the local government except in cases of emergency declared by unanimous vote of the governing body. Cal. Const. art. XIIIC, § 2(b).

ii) SPECIAL TAXES. No local government may impose, extend or increase any special tax until such tax is submitted to the electorate and approved by a two-thirds vote of the electorate voting in the election on the tax. Cal. Const. art. XIIIC, § 2(b). There are no timing restrictions on elections to approve special taxes.

PRACTICE TIP: In order to determine whether an agency action affecting a tax actually constitutes an "increase" subject to the requirements of Cal. Const. Articles XIII C and D, look to the definition of "increased" in Cal. Gov't Code section 53750 (h).

Note that Proposition 218 does not affect specific statutory requirements for special tax elections, for example, provisions for elections in community facilities (Mello-Roos) districts. See generallv, Cal. Gov't Code §§ 53311 et seq.

(e) THE EFFECT OF PROPOSITION 218 ON PROPOSITION 62. The California Supreme Court in Santa Clara Transportation Authority v. Guardino, 11 Cal. 4th 220, 45 Cal. Rptr. 2d 207 (1995), as modified on denial of rehearing (1995), upheld Proposition 62's requirements for general and special taxes. However, Guardino did not address the issue of whether its decision applied retroactively to taxes imposed between the dates November 5, 1986 (the effective date of Proposition 62) and the date of the Guardino decision (final decision effective December 11, 1995). Proposition 218 purports to apply retroactively back to January 1, 1995. See Cal. Const. art. XIIIC, § 2(c). However, the California Supreme Court in Howard Jarvis Taxpayers Assn. v. La Habra, 25 Cal. 4th 809, 825, 107 Cal. Rptr. 2d 369 (2001), held that the statute of limitations to challenging a tax measure under Proposition 62 begins anew each time the tax is collected. Thus, a city's utility tax adopted without voter approval even before January 1, 1995 (the beginning of the Proposition 218 window period) may likely still be subject to challenge under Proposition 62 each time the city collects the tax.

d. PROCEDURAL ISSUES

(1) PROCEDURE FOR ADOPTING GENERAL TAXES

(a) ACTION BY LEGISLATIVE BODY. Proposition 62 requires general taxes to be proposed by ordinance or resolution. Cal. Gov't Code § 53724(a). The legislative body must conduct both a public meeting and a public hearing in accordance with Government Code section 54954.6. But see Cal. Gov't Code § 54954.6(e). The ordinance or resolution must include the type of tax, the rate of tax and the method of collection. Id. A proposed tax may state "a range of rates or amounts." If a range of rates is approved, the governing body may impose up to the maximum amount approved. Cal. Gov't Code § 53739. A proposed tax may also provide for inflationary adjustments to the rate or amount, unless the tax is to be determined by using a percentage calculation. Id. Proposition 62 also states that enactment of general taxes requires a two-thirds vote of the legislative body. See Cal. Gov't Code § 53724(b). These requirements, being part of the section which also contains Proposition 62's voter-approval requirement for general taxes, appear to be valid. See Santa Clara County Local Transportation Authority v. Guardino, 11 Cal. 4th 220, 45 Cal. Rptr. 2d 207 (1995). See also section VII.A.2.c.(5) (above) of this handbook.

(b) VOTER APPROVAL. Both Proposition 218 and Proposition 62 require that general taxes are adopted upon approval of a majority of the votes cast by the voters. See Cal. Const. art. XIIIC, § 2(b); Cal. Gov't Code § 53723. See Santa Clara County Local Transportation Authority v. Guardino, 11 Cal. 4th 220, 45 Cal. Rptr. 2d 207 (1995) (finding the voter-approval provisions of Proposition 62 to be valid). The election to approve a general tax must be consolidated with a regularly-scheduled general election for members of the governing body of the local government except in cases of emergency declared by unanimous vote of the governing body. Cal. Const. art. XIIIC, § 2(b). Although the Elections Code authorizes a mail ballot for a general tax, an election to elect the legislative body may not be conducted wholly by mail. Cal. Elec. Code § 4000.

(2) PROCEDURE FOR ADOPTING SPECIAL TAXES

(a) ACTION BY LEGISLATIVE BODY. A decision on a special tax is placed on the ballot following adoption of an ordinance or resolution, at the conclusion of a noticed public hearing setting the issue before the voters. Cal. Gov't Code § 50077. Proposition 62 requires that the ordinance or resolution proposing the tax include the type of tax, its rate, the method of collection, the date upon which the election on the tax will be held and the purpose for which the special tax will be used. Cal. Gov't Code § 53724(a). A proposed tax may state "a range of rates or amounts." If a range of rates is approved, the governing body may impose up to the maximum amount approved. Cal. Gov't Code § 53739. A proposed tax may also provide for inflationary adjustments to the rate or amount, unless the tax is to be determined by using a percentage calculation. Id.

(b) VOTER APPROVAL. Special taxes are adopted upon approval of two-thirds of the votes cast by the voters. Cal. Const. art. XIIIA, § 4; Cal. Const. art. XIIIC, § 2(d). See also Cal. Gov't Code § 53722 and Santa Clara County Local Transportation Authority v. Guardino, 11 Cal. 4th 220, 45 Cal. Rptr. 2d 207 (1995) (finding the voter-approval provisions of Proposition 62 to be valid). An election ballot proceeding may be conducted wholly by mail if it does not fall on the date of a statewide election and it is authorized by the governing body of the local agency. Cal. Elec. Code § 4000.

PRACTICE TIP: The California Supreme Court's decision in Santa Clara County Local Transportation Authority v. Guardino, 11 Cal. 4th 220, 45 Cal. Rptr. 2d 207 (1995), leaves open a number of unanswered questions:

1. *Whether the decision is retroactive to general taxes adopted prior to the decision.*

2. *Whether taxpayers have any remedies for the refund of taxes paid under a tax ordinance that was not voter-approved.*

3. *What statute of limitations applies to taxes adopted without voter approval prior to the Guardino decision,*

4. *Whether Proposition 62 only applies to new taxes or also to tax increases.*

5. *Whether Proposition 62 applies to charter cities.*

6. *Whether Proposition 218 now has impliedly repealed Proposition 62.*

Until these questions are answered, caution is advised with respect to all actions involving the procedural or substantive aspects of Proposition 62.

(3) CRIMINAL ENFORCEMENT

California Penal Code sections 424 and 425 make it a felony to refuse to pay over public money received under a duty to pay it over. Thus, if a city's ordinance imposing a transient occupancy tax requires innkeepers to pay over taxes collected under the ordinance, it is a felony for an innkeeper to refuse to do so.

3. SPECIAL BENEFIT ASSESSMENTS AND DISTRICTS

a. NATURE OF A SPECIAL ASSESSMENT

(1) PURPOSE

Special benefit assessments ("special assessments") are charges levied to pay for public improvements which are imposed upon land or business within a pre-determined district according to the benefit received from the improvement. Essentially there are two reasons for the levy of special assessments:

(a) To equitably distribute the costs of public improvements to the benefitted parcels of real property; and

(b) To provide the owners of benefitted properties with the means for paying, over time, their share of the costs of financing public improvements at relatively low interest rates.

Special assessments are a commonly-used method of financing the construction, reconstruction, acquisition or maintenance of public improvements.

(2) FEATURES

The key to an assessment is the requirement it be levied in proportion to the special benefits received from the improvements. Anaheim Sugar Company v. County of Orange, 181 Cal. 212, 216, 183 P. 809 (1919). A special assessment involves four features:

(a) a special assessment is generally levied only upon land;

(b) a special assessment typically is not a personal liability of the person assessed;

(c) a special assessment is based wholly on special benefits received;

(d) a special assessment is specific both as to time and locality; and

Northwestern Etc. Company v. State Board of Equalization, 73 Cal. App. 2d 548, 552, 166 P. 2d 917 (1946).

(3) DISTINCTION BETWEEN ASSESSMENTS AND TAXES

A properly-levied special assessment, while levied pursuant to the taxation power, is distinguishable from a tax. Knox v. City of Orland, 4 Cal. 4th 132, 14 Cal. Rptr. 2d 159 (1992). Because a special assessment is "charged to real property to pay benefits that property has received from a local improvement" it is "strictly speaking, . . . not a tax at all." County of Fresno v. Malmstrom, 94 Cal. App. 3d 974, 983-984, 156 Cal. Rptr. 777 (1979). Therefore, special assessments are not subject to the limitations contained in California Constitution article XIIIA (Proposition 13), see Knox v. City of Orland, 4 Cal. 4th 132, 14 Cal. Rptr. 2d 159 (1992), or article XIIIB. City Council of the City of San Jose v. South, 146 Cal. App. 3d 320, 334-335, 194 Cal. Rptr. 110 (1983); County of Placer v. Corin, 113 Cal. App. 3d 443, 447, 449, 170 Cal. Rptr. 232 (1980). For material on special taxes, please see section VII.A.2.b. of this handbook.

PRACTICE TIP: A particular revenue measure may have attributes of more than one traditional revenue device and still be valid. Kern County Farm Bureau v. County of Kern, 19 Cal. App. 4th 1416, 23 Cal. Rptr. 2d 910 (1993). With proper support and analysis prior to adoption, therefore, a particular fee or charge may also be validated as a special assessment. Id.

b. STATUTORY FRAMEWORK

(1) IN GENERAL

California has a number of laws that permit assessment districts to be established to finance the construction and maintenance of public improvements. Some of the laws allow for bond financing in connection with procedures that authorize the establishment of an assessment district. Other laws only allow the levy of assessments.

(2) ASSESSMENT LAWS

The following statutes commonly are used in assessment district financing:

(a) IMPROVEMENT ACT OF 1911 (1911 ACT). The 1911 Act provides for the construction of certain public improvements together with limited acquisition of property necessary therefore, the levy of assessments and the issuance of bonds. See Cal. Sts. & High. Code §§ 5000 et seq. The 1911 Act as a procedure act has fallen into disuse since the bonds for refinancing the cost of improvements are issued only after completion of the project, thereby necessitating the contractor to finance the work. 1911 Act bonds, however, are sometimes issued under the procedures of the 1913 Act.

(b) THE MUNICIPAL IMPROVEMENT ACT OF 1913 (1913 ACT). The 1913 Act provides for the acquisition or construction of certain public improvements, the acquisition of property necessary therefore and the levy of assessments for the costs. It is the primary "procedural" assessment act used today. It has no bond procedures and bonds must be issued under either the 1913 or 1915 Act. See Cal. Sts. & High. Code §§ 10000 et seq.

(c) THE IMPROVEMENT BOND ACT OF 1915 (1915 ACT). The 1915 Act is strictly a statute providing for the issuance of bonds. Bonds may be issued under the 1915 Act to represent assessments levied under certain procedural acts such as the 1913 Act and the 1972 Act. 1915 Act bonds are the most prevalent assessment bonds issued today. See Cal. Sts. & High. Code §§ 8500 et seq.

(d) THE LANDSCAPING AND LIGHTING ACT OF 1972 (1972 ACT). The 1972 Act authorizes assessments to install, construct, and maintain landscaping, lighting, and park and recreational facilities, including graffiti removal. It has no bond procedures although bonds may be issued under the 1915 Act using it as the "procedural" act. See Cal. Sts. & High. Code §§ 22500 et seq.

(e) THE BENEFIT ASSESSMENT ACT OF 1982 (1982 ACT). The 1982 Act authorizes assessments to operate and maintain drainages, flood control, street lighting and street maintenance services and to install and improve drainage and flood control facilities. It has no bond procedures. Cal. Gov't Code §§ 54703 et seq.

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(f) PARKING AND BUSINESS IMPROVEMENT AREA LAW OF 1989. This Act authorizes assessments against businesses to finance improvements and activities to improve specific business areas and to promote tourism within those areas. Cal. Sts. & High. Code §§ 36500, et seq. Similar improvements and activities may be financed through assessments against real property pursuant to the Property and Business Improvement District Law of 1994. Cal. Sts. & High. Code §§ 36600 et seq. "Assessments" levied under the 1989 Act are not assessments subject to the requirements of Proposition 218. Howard Jarvis Taxpayers Association v. City of San Diego, 72 Cal. App. 4th 230, 84 Cal. Rptr. 2d 804 (1999).

(3) OTHER APPLICABLE STATUTES

It may be necessary to comply with two other statutes in assessment district formation: (1) the Special Assessment Investigation, Limitation and Majority Protest Act of 1931, Cal. Sts. & High. Code §§ 2800 et seq. and (2) the Notice of Special Assessment, Special Tax, and Foreclosure Proceedings Law, Cal. Sts. & High. Code §§ 3100 et seq. However, it should be noted that the Proposition 218 Omnibus Implementation Act purports to make itself the exclusive procedural statute for levying of special assessments, impliedly overriding the 1931 Act and other procedural statutes in conflict with it, except for Streets and Highways Code §§ 3100 et seq. (See Government Code Section 53753). The principal act should be reviewed to determine whether the requirements of either of these two statutes will nominally apply. In addition, California Constitution articles XIII C and D and statutory provisions implementing them have changed the procedural requirements for new and increased assessments, thereby eliminating the need to comply with the requirements of the Ralph M. Brown Act or other individual statutes, with the exception of California Streets and Highways Code section 3100 et seq. See section VII.A.3.d.2 of this handbook.

(4) CHARTER CITY AUTHORITY

Charter cities may enact their own procedural ordinances under their charter powers for assessment district formation and financing. See J.W. Jones Companies v. City of San Diego, 157 Cal. App. 3d 745, 203 Cal. Rptr. 580 (1984). Generally, such proceedings must comply with article XVI, section 19 of the California Constitution, which incorporates many of the provisions of the Special Assessment Investigation, Limitation and Majority Protest Act of 1931.

c. ASSESSMENT DISTRICTS

(1) NATURE OF AN ASSESSMENT DISTRICT

An assessment district is not a separate government agency but rather the defined area with property specially benefitted by certain public improvements and within which the special assessments are apportioned and levied according to some benefit formula approved by the legislative body. "[T]he establishment of a special assessment district takes place as a result of a peculiarly legislative process grounded in the taxing power of the sovereign." Dawson v. Town of Los Altos Hills, 16 Cal. 3d 676, 683, 129 Cal. Rptr. 97 (1976). Prior to Proposition 218, a very deferential standard was applied to actions of a city council in forming an assessment district. Id. See also Evans v. City of San Jose, 3 Cal. App. 4th 728, 4 Cal. Rptr. 2d 601 (1992); J. W. Jones Companies v. City of San Diego, 157 Cal. App. 3d 745, 203 Cal. Rptr. 580 (1984). See section VII.A.3.d.(6) of this handbook. A wide variety of facilities and improvements may be financed by special assessments. See, e.g., City of San Diego v. Holodnak, 157 Cal. App. 3d 759, 203 Cal. Rptr. 797 (1984).

(2) FORMATION OF AN ASSESSMENT DISTRICT

The procedures for establishing an assessment district and levying an assessment are creatures of statute or charter. However, it should be noted that the Proposition 218 Omnibus Implementation Act purports to make itself the exclusive procedural statute for the levying of special assessments, impliedly overriding the 1931 Act and other procedural statutes in conflict with it (see Government Code Section 53753). The steps typically involve the following:

(a) INITIATION. Proceedings may be initiated by petition signed by the persons proposed to be assessed or by action of the legislative body.

(b) PREPARATION OF ASSESSMENT ENGINEER'S REPORT. An assessment engineer must prepare a report for presentation to the legislative body generally containing:

i) A description of the improvements to be financed including plans and specifications (which may be general in nature);

ii) A cost estimate for the acquisition or construction of the improvements as well as the incidental and financing costs;

iii) An assessment diagram depicting the boundaries of the assessment district, any zones, and the parcels within the assessment district;

iv) A description of the method of spreading the assessments throughout the assessment district;

v) An assessment roll which is a list of all the parcels proposed to be assessed and the proposed assessment against the parcels; and

vi) The proposed maximum annual assessment per parcel to pay unreimbursed administration or registration costs.

California Constitution Article XIIID and statutory provisions implementing it require that all assessments must be supported by a detailed engineer's report prepared by a registered professional engineer.

(c) RESOLUTIONS. The legislative body approves a series of resolutions declaring its intention to form the assessment district, levy the assessments, order the works of improvement and issue bonds to represent the unpaid assessments. The legislative body also preliminarily approves the assessment engineer's report and sets the time and place for a public hearing when all persons who object to the proposed assessment district may appear and be heard by the legislative body.

(d) NOTICE OF HEARING. A notice of public hearing must be mailed to all property owners within the assessment district. See section VII.A.3.d.2 of this handbook.

(e) PROTEST. California Constitution articles XIIID and statutory provisions implementing it have amended the protest procedures for new and increased assessments, thereby eliminating the requirement that the owners of one half of the area to be assessed must protest, and eliminating the power of the legislative body to overrule a majority protest by a four-fifths vote. See section VII.A.3.d.2.b of this handbook.

(f) RECORDATION. The assessment roll is recorded in the office of the street superintendent and the office of the county recorder and the assessments become liens against the properties upon which they were levied.

(g) CASH COLLECTION. Notice is given to the property owners that they have 30 days to pay their assessments in cash. If the assessments are not paid within this time, the city may issue bonds secured by all assessments which remain unpaid.

(h) ISSUANCE OF IMPROVEMENT BONDS. The city issues bonds secured by the unpaid assessments.

PRACTICE TIPS:

1. There is a three-part test for analyzing the validity of any benefit district or assessment spread. First, identify the benefit to be received from the public improvement. Second, determine if the benefit received is a specific and direct benefit to the property within the district. Third, determine if the spread formula is based upon the individual benefits received. See Harrison v. San Mateo County, 44 Cal. App. 3d 852, 118 Cal. Rptr. 828 (1975). The boundaries of the district should be drawn to include all land for which a special benefit from the improvements is identified.

2. Essential to any successful assessment district is the engineer's report which defines the estimated cost of the improvements and spreads the benefit among the various parcels. While there are a number of different assessment district proceedings, most of them have the common feature of the Special Assessment Investigation, Limitation and Majority Protest Act requirement (which may no longer be applicable under the Proposition 218 Omnibus Implementation Act). Special care must be taken to meet procedural provisions of assessment district laws as compliance with such requirements may be jurisdictional. Various federal tax issues may also arise in connection with the issuance of bonds. While discussion of those issues are beyond the scope of this handbook, particular concern must be paid to arbitrage and administration of the construction fund, including distribution of any surplus in the construction fund in accordance with California Streets and Highways Code sections 10427 and 10427.1. For this reason, it is customary to retain the services of qualified "bond counsel" to administer the assessment proceedings.

3. For more discussion of the possible impacts of Proposition 218, see the League of California Cities' implementation guide on Proposition 218 (2000 edition). Copies of the guide are available through the League. For more information contact the League's publication unit at 1400 K Street, 4th Floor, Sacramento, CA 95814, 916/658-8257, FAX 916/658-8220.

d. PROPOSITION 218

(1) IN GENERAL

Proposition 218 affects special assessments in five principal ways:

(a) it subjects assessments to repeal or reduction by initiative,

(b) it establishes procedural requirements for the levy of assessments, including the requirement for property owner approval by a new mail ballot process,

(c) it requires the local agency to separate the general benefits from the special benefits conferred on a parcel, and to only assess for the special benefit,

(d) it requires public agencies to be assessed in certain instances, and

(e) it alters the burden of proof in legal actions to contest the validity of an assessment.

(2) GENERAL VS. SPECIAL BENEFIT

Proposition 218 provides that only "special benefits" are assessable. Under prior law, only properties receiving special benefit were assessable, but the fact that some incidental general benefit also resulted from a capital improvement or maintenance did not invalidate an assessment apportioning some or all of the general benefit to specially benefitted properties within the assessment district. Under Proposition 218, the costs associated with general benefit must be paid from other resources of the local agency. See Cal. Const. art. XIIID § 4(a).

PRACTICE TIP: The League of California Cities has published an implementation guide on Proposition 218 (2000 edition). Copies of the guide are available through the League. For more information contact the League's publication unit at 1400 K Street, 4th Floor, Sacramento, CA 95814, 916/658-8257, FAX 916/658-8220.

(3) PROCEDURAL REQUIREMENTS

Proposition 218 creates new requirements for the imposition by a local agency of a "new or increased" special assessment. See Cal. Const. art. XIIID, §§ 4(c), (d), (e). In order to determine whether an agency action affecting an assessment actually constitutes an "increase" so that it is subject to the requirements of Proposition 218, look to the definition of "increased" in Government Code section 53750 (h).

PRACTICE TIP: Any new or increased assessment that is subject to the notice and hearing provisions of articles XIII C or D of the California Constitution is not subject to the notice and hearing requirements of Government Code section 54954.6. Cal. Gov't Code § 54954.6(h).

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(a) PUBLIC HEARING AND NOTICE REQUIREMENTS. Proposition 218 requires the following:

i) 45 days mailed notice to record owner of each parcel, eliminates the published notice option in the Brown Act for assessment districts which are coterminous with local government boundaries or for assessment districts of 50,000 parcels or more.

ii) The notice, protest, and hearing requirements of Government Code section 53753 supersede any statutory provisions affecting new or increased assessments that were in existence on July1, 1997. Thus an agency need only comply with these requirements and not those contained in the specific statutory provisions under which an agency is levying the assessment. Notwithstanding these provisions, an agency must still comply with Streets and Highways Code section 3100 et seq. where appropriate. Cal. Gov't Code §§ 53753, 54954.6(h).

iii) The contents of the notice must include, among other things, the total assessment for the entire assessment district, assessment charge on owners' parcels, duration of proposed assessment, reason for assessment, basis on which amount of proposed assessment was calculated, date, time and place of public hearing and summary of voting procedures and effect of majority protest. Cal. Gov't Code § 53753(b). A proposed assessment may state "a range of rates or amounts." If a range of rates is approved, the governing body may impose up to the maximum amount approved. Cal. Gov't Code § 53739. A proposed assessment may also provide for inflationary adjustments to the rate or amount, unless the assessment is to be determined by using a percentage calculation. Id.

iv) On the date stated in the notice, the agency shall conduct a public hearing at which the agency shall consider all objections or protests, if any, to the proposed assessment. At the public hearing, any interested person shall be permitted to present written or oral testimony. Cal. Gov't Code § 53753 (d).

(b) PROTEST BY BALLOT. Property owners may now express their support or opposition to proposed assessment by ballot which must accompany the notice. Sealed ballots must be returned before conclusion of the public hearing and tabulated after the conclusion of the public hearing. (See Government Code section 53753(e), requiring ballots to remain secret until the close of the public hearing.) No assessment may be imposed if a "majority protest" exists. The legislative body may not overturn a majority protest by a four-fifths vote. Majority protests exist if ballots submitted in opposition exceed ballots submitted in favor of assessment. The protest is weighted according to proportional financial obligations of the affected property (i.e., the amount of the assessment) and modifies pre-existing law which generally required owners of 50 percent or more of property proposed to be assessed (determined by acreage) to file a written protest in order to establish a majority protest. See Cal. Const. art. XIIID. Cal. Gov't Code § 53753 (c) and (e).

(c) ASSESSMENT BALLOT PROCEEDINGS CONDUCTED BY MAIL. Assessment ballot proceedings may be conducted wholly by mail where authorized by the governing body of the local agency, and where they do not fall on the date of a statewide election. Cal. Elec. Code § 4000. In such case, the proceeding shall be denominated an "Assessment Ballot Proceeding" rather that an election, and the ballots shall be denominated "Assessment Ballots." Id. The assessment ballot procedures do not constitute elections for purposes of the Election Code. Cal. Gov't Code § 53753(e)(4).

(4) EFFECTIVE DATE OF NEW PROCEDURES

Proposition 218 is not entirely clear as to the effective date of the new assessment procedures. In general, the provisions of California Constitution article XIIID became effective on November 6, 1996.

(5) ASSESSMENT OF PUBLIC PROPERTY

Proposition 218 states that public property "shall not be exempt from assessment unless the [levying] agency can demonstrate by clear and convincing evidence that those publicly owned parcels in fact received no special benefit." See Cal. Const. art. XIIID, § 4(a). Notwithstanding this, property of the federal government is immune from assessment under the U.S. Constitution's "Supremacy Clause." See Novato Fire Protection District v. United States, 181 F.3d 1135 (9th Cir. 1999).

(6) BURDEN OF PROOF

Proposition 218 eliminates the presumption in favor of the local agency's determinations. Dawson v. Town of Los Altos Hills, 16 Cal. 3d 676, 129 Cal. Rptr. 97 (1976). Local agencies will now be required to show, based upon the record created before the legislative body, that a valid method was used to identify the special benefit to be received from an improvement, that all parcels who received a special benefit had been identified and included within the district, that the cost of the improvement has been reasonably apportioned among the benefitted parcels according to special benefits and that the costs attributable to general benefits to the public at large are not paid from special assessments. See Cal. Const. art. XIIID, § 4(f).

(7) EXEMPTIONS

(a) ASSESSMENTS EXISTING ON NOVEMBER 6, 1996. Assessments which were "existing" on November 6, 1996, the effective date of California Constitution article XIIID, and which fall within one of the four exceptions identified in section 5 of article XIIID are exempt from the procedures and approval processes in section 4 of article XIIID. The four exceptions set forth in section 5 are as follows:

i) Any assessment imposed exclusively to finance the capital cost or maintenance and operation expenses for sidewalks, streets, sewers, water, flood control, drainage systems or vector control. Cal. Const. art. XIIID, § 5(a). This exemption includes assessments for street lights. Howard Jarvis Taxpayers Assn. v. City of Riverside, 73 Cal. App. 4th 679, 85 Cal. Rptr. 2d 92 (1999).

ii) Any assessment imposed pursuant to a petition signed by the persons owning all of the parcels subject to the assessment at the time the assessment is initially imposed. Cal. Const. art. XIIID, § 5(b).

iii) Any assessment the proceeds of which are exclusively used to pay bonded indebtedness of which the failure to pay would violate the contract impairment clause of the Constitution of the United States of America. Cal. Const. art. XIIID, § 5(c).

iv) Any assessment which previously received a majority vote approval from the voters voting in an election on the issue of the assessment. Cal. Const. art. XIIID, § 5(d).

(b) REASSESSMENT PURSUANT TO STREETS AND HIGHWAYS CODE. Any reassessment that is approved and confirmed pursuant to Streets and Highways Code section 9525 shall not be deemed to be an assessment within the meaning of, and may be ordered without compliance with the procedural requirements of, article XIIID of the California Constitution. Cal. Sts. & Hwy Code § 9525.

(c) NON-PROPERTY-BASED ASSESSMENTS. The provisions of Proposition 218 do not apply to assessments that are imposed on businesses rather than parcels of property (e.g., assessments levied pursuant to the Parking and Business Improvement Area Law of 1989). Howard Jarvis Taxpayers Assn. v. City of San Diego, 72 Cal. App. 4th 230, 84 Cal. Rptr. 2d 804 (1999).

(d) ALL OTHER ASSESSMENTS. All other existing, new, or increased assessments must comply with the provisions of Proposition 218 beginning July 1, 1997. See Cal. Const. art. XIIID, § 5.

PRACTICE TIP: If an agency has once complied with the notice, protest, and hearing requirements of Government Code section 53753, or the assessment was exempt from such requirements, there is no need to comply with those requirements in subsequent fiscal years unless the assessment methodology is changed, or the amount of the proposed assessment exceeds the stated assessment formula range. Cal. Gov't Code § 53753.5. Notwithstanding this rule, increases in an assessments listed in paragraph (1), (2) or (4) of Government Code section 53753.5(5) shall be subject to the procedures and approval process set forth in section 4 of article XIII D of the California Constitution. Id.

(8) USE OF INITIATIVES TO REDUCE OR REPEAL ASSESSMENTS

Proposition 218 provides that the initiative power may be used to reduce or repeal any local tax, assessment, fee or charge. See Cal. Const. art. XIIIC, § 3.

4. FINES AND FORFEITURES

a. GENERAL STATUTE FOR DISTRIBUTION

The distribution of municipal court fines and bail forfeitures is determined by state law. See generally Cal. Penal Code §§ 1463, 1463.001, 1463.002. The distribution of base fines for arrests within a city is as follows: prior to July 1, 1998, the county receives the amount specified in Penal Code section 1463.002, with the remainder evenly divided between the county and city; effective July 1, 1998, the county will receive the amount specified in Penal Code section 1463.002, with the remainder going solely to the city. See Cal. Penal Code § 1463.001(b)(3).

b. FINES "AVAILABLE FOR DISTRIBUTION"

(1) AMOUNTS PAID

The amount paid by a defendant includes the fine, see, e.g., Cal. Veh. Code § 23160 (for driving under the influence), and various penalties and assessments, see, e.g., Cal. Penal Code § 1464, Cal. Gov't Code § 76000, Cal. Veh. Code §§ 23645, 42006, and may include restitution. See Cal. Penal Code § 1202.4. These "add-ons" are changed by the legislature frequently and may exceed the amount of the fine. Unless modified by a judge (often pursuant to a plea agreement), the base fine is derived from the Uniform Bail and Penalty Schedule as adopted by the Judicial Council (infractions), Vehicle Code § 40310, Rules of Court 850, or county judges (misdemeanors and felonies), Penal Code § 1269(b). Judicial Council Bail and Penalty Schedules available at http://www.courtinfo.ca.gov/reference/documents/2001bail.pdf.

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(2) AMOUNT AVAILABLE FOR DISTRIBUTION

The amount available for distribution to the city and the county pursuant to California Penal Code sections 1463.001 and 1463.002 is the amount of the fine, less $20 to the state Restitution Fund for victims (for driving under the influence), Cal. Penal Code § 1463.18, and less penalties and assessments and amounts payable to county alcohol programs, see Cal. Penal Code §§ 1463.16, 1463.25, and for blood, breath and urine analysis. See Cal. Penal Code § 1463.14.

(3) INSTALLMENT PAYMENTS

The total fines and assessments may be paid in installments. Cal. Penal Code § 1205(d). Proration of each installment payment between the different entities (state, county, city) entitled to the monies is required. See Cal. Penal Code § 1462.5; Cal. Gov't Code § 71380. See also State Controller's "Manual of Accounting and Audit Guidelines for Municipal and Justice Courts" (1985).

c. EXCEPTION TO GENERAL DISTRIBUTION STATUTE

(1) GENERAL EXCEPTION

A different distribution occurs when: 1) the fine is collected by a probation officer; and 2) the fine is paid as a condition of probation. See Cal. Penal Code § 1203.1(k); Los Angeles County v. Emme, 42 Cal. App. 2d 239, 108 P. 2d 695 (1940). When this occurs, all fines collected are deposited in the county's general fund. Cal. Penal Code § 1203.1(k).

(2) CONDITIONAL SENTENCES

California Penal Code section 1203.1 applies when the defendant is on probation (as defined in California Penal Code section 1203(a)), but not when the defendant is on "conditional sentence" (formerly referred to as "summary" or "court" probation). City of Victorville v. County of San Bernardino, 233 Cal. App. 3d 1312, 285 Cal. Rptr. 206 (1991).

d. FORFEITURES OF BAIL

(1) CASH BAIL

If the defendant fails to appear, cash bail is distributed pursuant to California Penal Code section 1463.009.

(2) BOND

If a bond is posted in lieu of cash bail, upon the defendant's failure to appear and the surety's failure to make good on the bond, summary judgment automatically is entered against the surety, see Cal. Penal Code § 1306, and the amount collected by the county pursuant to the summary judgment is distributed pursuant to California Penal Code section 1463.001. City of Los Angeles v. County of Los Angeles, 216 Cal. App. 3d 916, 265 Cal. Rptr. 461 (1989).

e. PARKING FINES AND FORFEITURES

(1) IN GENERAL

Violations of local, state and federal regulations that are not misdemeanors respecting the standing or parking of vehicles are subject to only civil penalties and are governed by the civil administrative process in California Vehicle Code sections 40200 et seq. As civil matters, there is no right to confront adverse witnesses. The notice of parking violation, or a copy of it, is considered a record kept in the ordinary course of business of the issuing agency and the processing agency and must be prima facie evidence of the facts contained in it. Cal. Veh. Code § 40202. If the parking violation is contested, the ticketing agency bears the civil standard of proof by preponderance of the evidence.

(2) TICKET PROCESSING

Agencies issuing parking tickets may elect to contract for the processing of parking tickets with other governmental issuing agencies within that county (other than the California Highway Patrol, the California State Police, or other state law enforcement agency) or with private vendors. Prior to November 6, 1996, special consideration to minority business enterprise participation in the provision of services must be given if a private vendor is sought. See Cal. Veh. Code § 40200.5(a). Effective November 6, 1996, the state shall not grant preferential treatment to any individual or group based on race, sex, color, ethnicity, or national origin in the operation of public contracting. See Cal. Const. art. I, § 31(a).

(3) LIABILITY FOR PENALTIES AND AMOUNTS

With certain exceptions, the vehicle's registered owner and driver, renter or lessee are jointly liable for parking penalties. Cal. Veh. Code §§ 40200 (liability), 40209 (exceptions). An owner who pays any parking penalty may seek recovery from the driver, renter or lessee. The amounts of penalties, administrative fees and other related charges for parking violations are to be established by the governing body of the issuing agency. But to the extent possible, issuing agencies within a county must standardize penalties. See Cal. Veh. Code § 40203.5.

(4) APPORTIONMENT AMONG AGENCIES

State law apportions revenues for parking violations and surcharges between issuing agencies and the counties. See Cal. Veh. Code § 40200.3.

(5) ADMINISTRATIVE PROCESS

(a) ADMINISTRATIVE INVESTIGATION AND REVIEW PROCESS. Within 21 days from the issuance of parking citation or 14 days from the mailing of the notice of delinquent parking violation, a person by written request, telephone or in person may request review by the processing agency. Cal. Veh. Code § 40215. The processing agency has the discretion to refer that review to the issuing agency. The results of the investigation must be mailed to the person seeking review.

(b) ADMINISTRATIVE HEARING. Anyone dissatisfied with the results of the investigation may request a hearing by depositing the full amount of the parking penalty with the processing agency and providing a written explanation to the agency as to why the parking violation is being contested. The investigation and administrative review procedures are detailed in California Vehicle Code section 40215(b).

(c) RELIEF FROM DEPOSIT REQUIREMENTS. The processing agencies must also adopt and provide a procedure whereby the indigent are relieved from the deposit requirements. See Cal. Veh. Code § 40215(b).

(d) REVIEW. The person contesting the ticket has the right to elect a review by mail or personal conference. Minors have the same appearance rights and may be processed the same as adults. The examiner who conducts the review must be designated by the issuing agency's governing body or chief executive officer. The examiner must be independent from the enforcement agency and the citation collection process. An examiner's employment, performance evaluation or compensation cannot be linked to the amount of fines collected by the examiner. Examiners shall have a minimum of 20 hours of training. The review is to be conducted in accordance with written procedures established by the imposing or processing agency and must assure a fair and impartial review. The agency's final decision may be given by the examiner directly to the person contesting the ticket or by first class mail. See Cal. Veh. Code § 40215.

(6) TRIAL DE NOVO BY COURT

Within 30 days following the mailing of the agency's examiner's decision, a parking ticket contestant may appeal to the justice or municipal court. Although the hearing is de novo, the processing agency's file in the case must be received into evidence and a copy of the notice of parking violation is deemed prima facie evidence of the facts provided. The appeal requires a $25 filing fee, which, if the contestant is successful, must be refunded by the processing agency along with any deposit of parking penalty. If the court decision is in favor of the agency and the contestant has not previously deposited the penalty, the agency may initiate collection efforts. See Cal. Veh. Code § 40230.

(7) COLLECTION OF UNPAID PARKING PENALTIES

Once the contestant has allowed an administrative or court decision to become final by not taking timely advantage of a further administrative step or appellate proceeding, the processing agency may proceed with several collection procedures if a full·deposit of the penalty has not already occurred. Generally only one of these collection options may be pursued at any given time.

(a) COLLECTION WITH VEHICLE REGISTRATION. The processing agency may file an itemization of unpaid parking penalties and service fees with the Department of Motor Vehicles (DMV) for collection with the registration of the vehicle. See Cal. Veh. Code § 40220(a).

(b) AS JUDGMENT FOR CIVIL DEBT. When unpaid penalties and fees against any person or owner exceed $400, proof of that civil debt may be filed with the court with the same effect as a civil judgment. This option requires 21 days' mailed notice explaining a judgment will be entered and, after the 21 days, will have the same effect as an entry of judgment against a judgment debtor. The notice must also advise the debtor execution may be levied and other steps may be taken to satisfy the judgment. A first paper filing fee is required of the agency at the time entry of civil judgment is requested. See Cal. Veh. Code § 40220(b). This option is also available if the vehicle's registration has not been renewed more than 60 days after its renewal date and the citation has not been collected by the DMV. See Cal. Veh. Code § 40220(c).

(8) EQUIPMENT AND REGISTRATION TAB VIOLATIONS

Equipment and registration tab violations added to the parking citation must be handled in the same fashion as parking violations except the penalties are specified by the Uniform Bail and Penalty Schedule. See Cal. Veh. Code § 40225.

f. CRIMINAL JUSTICE PENALTIES

A penalty of $2.50 may be imposed by resolution on each parking citation for both a county criminal justice facilities construction fund and a courthouse construction fund. Cal. Gov't Code § 76000. The bail schedule is to be increased by these penalties. Cal. Gov't Code § 76000(b). A city which processes its own parking fines by contract is to pay these penalties to the county treasurer. Cal. Gov't Code § 76000(b).

5. FRANCHISE FEES

a. INTRODUCTION

The revenue paid to a municipality from a franchisee is in effect "rental" or "tolls" for the use of its streets. San Francisco-Oakland Terminal Railways v. Alameda County, 66 Cal. App. 77, 82, 225 P. 304, 306 (1924). This section addresses franchise fees as a revenue source. For material relating to cities' powers and procedures for actually enacting franchises, please see the discussion of franchises and utilities at section IV.C.5. of this handbook.

b. FRANCHISE FEES

(1) ELECTRIC AND TELEPHONE POLES AND WIRES AND GAS AND OIL PIPELINES

(a) IN GENERAL. The Broughton Act, Cal. Pub. Util. Code §§ 6001 et seq., allows franchise payments of two percent of the franchise's gross annual receipts arising from the use, operation or possession of the franchise. Cal. Pub. Util. Code § 6006. This section applies to intrastate utilities (electric and telephone poles and wires, as well as gas pipes) but does not apply to cable television systems. See Cal. Pub. Util. Code § 6001.

(b) TWO PERCENT DEFINED. The California Supreme Court has upheld the statute and established a methodology for allocating the franchise payments. See Tulare County v. City of Dinuba, 188 Cal. 664, 680-681, 206 P. 983 (1922) (holding the percentage is calculated on miles of distribution system in franchised area). The courts rejected a county's efforts to recalculate the two percent in County of Sacramento v. Pacific Gas and Electric Company, 193 Cal. App. 3d 300, 238 Cal. Rptr. 305 (1987).

(c) ALTERNATIVE PROCEDURE. The Franchise Act of 1937 (1937 Act) creates an alternative procedure for granting of electrical, oil, gas and water franchises. Cal. Pub. Util. Code §§ 6201 et seq., 6204. Like the Broughton Act, the 1937 Act provides for a franchise fee of two percent of the franchisee's gross annual receipts arising from the use, operation, or possession of the franchise but no less than one-half percent of gross annual receipts derived from the sale of electric franchises or one percent of gross annual receipts derived from the sale of gas or water, as the case may be, within city limits. Cal. Pub. Util. Code § 6231.

(d) APPLICATION TO CHARTER CITIES. With the exception of oil pipeline fees (see below), the Broughton Act and 1937 Act franchise fee restrictions are not applicable to charter cities. Thus, charter cities may set fees in excess of the two percent limit. Cal. Pub. Util. Code § 6205.

(e) SURCHARGE IN LIEU OF FRANCHISE FEES. A transportation customer which is a person, firm or corporation purchasing gas or electricity from a third person, but receiving transportation service from a utility or nonutility natural gas or electricity energy transporter which is subject to a franchise, is required to pay a municipal surcharge for the use of public lands. The surcharge replaces, but does not increase, franchise fees. Cal. Pub. Util. Code §§ 6350 et seq.

(f) OIL PIPELINE FRANCHISE FEES. On and after January 1, 1990, the fees imposed on a pipeline system that is a common carrier and transmits oil or products thereof is limited to the formula in California Public Utilities Code section 6231.5, which establishes a rate per lineal foot based on diameter of the pipeline. This formula applies to charter cities as well as general law cities. Cal. Pub. Util. Code §§ 6001.5, 6205.1. The statutory formula does not apply to non-public utility pipelines for industrial gas or oil.

(2) CABLE TELEVISION FRANCHISE FEES

The maximum cable community franchise television franchise fee is five percent of the grantee's gross receipts from its operations within the city. Cal. Gov't Code § 53066(c). This restriction applies to charter and general law cities. Cox Cable San Diego, Inc. v. City of San Diego, 188 Cal. App. 3d 952, 233 Cal. Rptr. 735 (1987). See also 47 U.S.C.A. § 542(b); Group W Cable, Inc. v. City of Santa Cruz, 679 F. Supp. 977 (N.D. Cal. 1988).

(3) REFUSE COLLECTION FRANCHISE FEES

A city may contract for the collection or disposal of solid waste under the terms and conditions prescribed by its legislative body. Cal. Pub. Res. Code § 49300. Determination of whether solid waste handling services are to be provided by means of a wholly exclusive, partially exclusive or nonexclusive franchise is to be made by the local governing body. Cal. Pub. Res. § 40059. There do not appear to be any statutory restrictions on the amount a city can charge the franchisee as a franchise or collection fee. Cf. Cal. Pub. Res. Code § 49031 (procedures to adopt refuse fees charged to consumers).

(4) RECYCLING, HOUSEHOLD HAZARDOUS WASTE AND OTHER WASTE MANAGEMENT ACTIVITIES

Statutory law does not provide explicit authorization to issue franchises for recycling, household hazardous waste and other waste management activities, but an implicit acknowledgment of the power to do so is found in California Public Resources Code section 47109.

6. FEES, CHARGES AND RATES

a. IN GENERAL

(1) DEFINITIONS

(a) CHARGES, RATES AND FEES. These terms are defined in a number of ways under California statutory provisions. Often the terms are synonymous. See, e.g., Cal. Gov't Code §§ 54314, 66000(b), 66007; Cal. Pub. Util. Code § 210; Cal. Water Code §§ 20541, 34034; Cal. Pub. Res. Code § 13015; Cal. Health & Safety Code §§ 4955. While all are monetary exactions, as used in this handbook:

i) RATES OR CHARGES. "Rates" or "charges" will generally refer to the potentially ongoing monetary exactions for use of a revenue-producing enterprise such as parking lots, water and sewer treatment, supply or collection facilities, public airports or garbage disposal service. In some cases, "charges" will refer to an amount imposed for the use of or access to a city's personal property.

ii) FEES. "Fees" will generally refer to exactions for the costs of providing a particular service, such as issuance of a building permit or connection to a sewer or water line.

(b) GENERAL TAX. A general tax is an economic burden imposed by government to raise revenue for general governmental purposes. Knox v. City of Orland, 4 Cal. 4th 132, 142, 14 Cal. Rptr. 2d 159 (1992).

(c) SPECIAL TAX. A special tax is an economic burden imposed by government and earmarked for a specific purpose. Knox v. City of Orland, 4 Cal. 4th 132, 142, 14 Cal. Rptr. 2d 159 (1992).

(d) ASSESSMENTS. Assessments are monetary exactions for improvements which are beneficial to certain properties or individuals and are imposed in proportion to the special benefit conferred on such properties or persons. Knox v. City of Orland, 4 Cal. 4th 132, 142, 14 Cal. Rptr. 2d 159 (1992); San Marcos Water Dist. v. San Marcos Unified Sch. Dist., 42 Cal. 3d 154, 161, 228 Cal. Rptr. 47, 51 (1986); Cal. Gov't Code § 53750.

PRACTICE TIP: A particular revenue measure may have attributes of more than one traditional revenue device and still be valid. Kern County Farm Bureau v. County of Kern, 19 Cal. App. 4th 1416, 23 Cal. Rptr. 2d 910 (1993). With proper support and analysis prior to adoption, therefore, a particular fee or charge may also be validated as a special assessment. Id.

(2) AUTHORITY

(a) POLICE POWER. A city has the authority to impose fees, charges and rates under its police power. "As long as the local enactments are not in conflict with general laws, the power to impose valid regulatory fees is not dependent on any legislatively authorized taxing power, but exists pursuant to the direct grant of police power under article XI, section 7 of the California Constitution. County of Plumas v. Wheeler, 149 Cal. 758, 87 P. 909 (1906). It is this grant of authority which allows cities to impose fees for regulatory purposes. See also Associated Home Builders, etc., Inc. v. City of Walnut Creek, 4 Cal. 3d 633, 94 Cal. Rptr. 630 (1971).

(b) STATUTORY. "In addition to other powers, a legislative body may perform all acts necessary or proper to carry out the provisions of this title." Cal. Gov't Code § 37112.

(3) AMOUNT OF FEE

(a) RELATIONSHIP TO COSTS. A fee may not exceed the estimated reasonable cost of providing the service or facility for which the fee is charged. A fee which does exceed such cost may be considered a special tax. Carlsbad Mun. Water Dist. v. QLC Corp, 2 Cal. App. 4th 479, 485, 3 Cal. Rptr. 2d 318 (1992); City of Dublin v. County of Alameda, 14 Cal. App. 4th 264, 281, 17 Cal. Rptr. 2d 845 (1993). See Cal. Gov't Code § 50076. In addition, fees, charges and rates must be reasonable, fair and equitable in nature and proportionately representative of the costs incurred by the regulatory agency. Associated Homebuilders of the Greater East Bay v. City of Livermore, 56 Cal. 2d 847, 17 Cal. Rptr. 5 (1961); United Business Commission v. City of San Diego, 91 Cal. App. 3d 156, 165, 154 Cal. Rptr. 263 (1979). See also McClain v. City of South Pasadena, 155 Cal. App. 2d 423, 318 P. 2d 199 (1957) (rates to non-residents).

(b) INDIRECT COSTS. In fixing the fee, it is proper and reasonable to take into account not only the expense merely of direct regulation, but all the incidental consequences that may be likely to subject the public to cost. United Business Commission v. City of San Diego, 91 Cal App. 3d 156, 165, 154 Cal. Rptr. 263 (1979) (quoting County of Plumas v. Wheeler, 149 Cal. 758, 87 P. 909 (1906)).

(c) IN LIEU FEES. Calculations supporting any transfers to the general fund from a utility fund need to show why the utility fees or charges do not exceed the reasonable costs of providing that service, and describe the extent of any benefit the utility enterprise is receiving from general fund operations or assets. Cal. Gov't Code § 50076. See also, League of California Cities, Proposition 218 Implementation Guide, (2000).

b. DEVELOPMENT FEES

"Development fees" are specifically defined by California Government Code section 66010 to include fees imposed in connection with approval of a development project for the purpose of defraying all or a portion of the cost of public facilities related to the development project. Development fees do not include fees for processing applications for governmental regulatory actions or approvals. If the agency imposing the fee does not "approve" the project subject to the fee, or if the fee is not imposed in connection with the "approval" of a project, the fee is not a development fee as defined in Government Code section 66000. Capistrano Beach Water Dist. v. Taj Development, 72 Cal. App. 4th 524, 85 Cal. Rptr. 2d 382 (1999) (water capacity and connection fees). Section V.B.9 of this handbook contains a discussion of the procedural and substantive requirements for the adoption and imposition of development fees.

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c. DEVELOPMENT PROCESSING FEES, RECOVERY OF COSTS OF PROVIDING PUBLIC SERVICES AND USER FEES

(1) DEVELOPMENT PROCESSING FEES

(a) RELATIONSHIP TO COST. Fees for building and use permits, zoning variances and changes, building inspections, map applications and planning services, and water or sewer connections may not exceed the reasonable cost of providing the service, unless the fee in excess of that amount is approved by a popular vote of two-thirds of those voters voting on the issue. Cal. Gov't Code §§ 66013, 66014.

(b) PROCEDURAL REQUIREMENTS. Prior to approving a new or increased fee or service charge, a city must:

i) Hold at least one public hearing;

ii) Publish notice of the hearing twice at least ten days before the hearing;

iii) Send notice of the meeting at least 14 days in advance to any interested person who has filed a written request; and

iv) Make available to the public at least ten days before the meeting data indicating the amount of estimated cost required to provide the service for which the fee or charge is levied and the revenue sources anticipated to provide the service, including general fund revenues.

Cal. Gov't Code §§ 66016, 66018.

(c) EFFECTIVE DATE. Any action adopting or increasing a fee or charge for development projects may not take effect for at least 60 days. Cal. Gov't Code § 66017.

(2) WATER, SANITATION, SOLID WASTE AND SEWER FEES AND RATES

Water, sanitation and sewer fees under California Health and Safety Code sections 5470 et seq., must be established by ordinance, adopted by a two thirds vote and may not be established by resolution unless acting pursuant to Revenue Bond Law of 1941. Cal. Health & Safety Code § 54344; Pinewood Investors v. City of Oxnard, 133 Cal. App. 3d 1030, 184 Cal. Rptr. 417 (1982). Setting of charges for solid waste handling services is a local concern. Cal. Pub. Res. Code § 40059.

(3) RECOVERY OF COSTS OF PROVIDING PUBLIC SERVICES

Generally, a general law city may not recover costs for providing public services and exercising the police power absent authorizing legislation. City of Flagstaff v. Atchinson, Topeka & Santa Fe, 719 F.2d 322, 323 (9th Cir. 1983); County of San Luis Obispo v. Abalone Alliance, 178 Cal. App. 3d 848, 223 Cal. Rptr. 846 (1986). For an example of such authorizing legislation, see California Government Code sections 53150 et seq., which authorizes a city to collect reasonable costs incurred in responding to an emergency caused by a person who is under the influence of drugs or alcohol.

d. RATES

(1) AUTHORITY

A local agency may operate, maintain, repair or manage all or any part of a revenue-producing enterprise. It may prescribe, revise and collect charges for the services, facilities or water furnished by the enterprise. Cal. Gov't Code §§ 54342, 54344. Specific kinds of enterprises and activities may be governed by specific statutes. See, e.g., Cal. Gov't Code §§ 54984 et seq. (the Uniform Standby Charge Procedures Act, which provides procedures for the levy and collection of water and sewer availability charges).

(2) RATE-SETTING PROCEDURES

A resolution or ordinance setting or revising rates must be adopted in accordance with state law, which requires:

(a) Notice of hearing must be given by the city clerk and must contain a copy of the proposed resolution or ordinance; and

(b) The notice must be published at least once each week for two weeks prior to a hearing in a newspaper published in the local agency (the first publication must be 15 days prior to the date of the hearing).

Cal. Gov't Code § 54354.5.

(3) PREFERENTIAL RATES FOR CITY RESIDENTS

The rates charged to residents may be lower than the rates charged to non-residents if the lower rates reflect support provided to the utility by residents from other sources such as property taxes. Hansen v. City of San Buenaventura, 42 Cal. 3d 1172, 233 Cal. Rptr. 22 (1986).

(4) COLLECTION AND NON-PAYMENT

(a) INCENTIVES AND PENALTIES. In providing for the collection of rates, a city may grant discounts for prompt payment, require deposits or the prepayment of charges, or require guarantees by the owner of the property. Cal. Gov't Code § 54347. Cities may provide for penalties for non-payment or may discontinue any or all service for which the bill is rendered. Cal. Gov't Code §§ 54346, 54348.

(b) BILLING. Cities may require charges for sewer services be collected and billed with charges for other utility services; they may also contract with a privately-owned public utility for collection of the rates. Cal. Gov't Code §§ 54345, 54346.1.

e. CHARGES

A city may impose a charge for the purpose of raising revenue for access to its personal property, such as its community services recreation guide or city-wide newsletter. Standards for the use of such property should be developed and approved by city council resolution; the standards should be reviewed for First Amendment implications. See section V.F. (regarding the First Amendment) of this handbook.

f. EFFECT OF BANKRUPTCY AUTOMATIC STAY ON COLLECTION

The filing of a bankruptcy petition by a debtor to the city may inhibit the city's ability to recover costs or other revenues. The filing of a bankruptcy petition operates as an automatic stay of any effort to collect debts incurred prior to the commencement of the bankruptcy action, 11 U.S.C. § 362, including in certain circumstances the filing of a notice of tax lien. Pinkstaff v. United States of America, 974 F.2d 1131 (9th Cir. 1992).

In limited circumstances, debts incurred after the bankruptcy petition is filed may be collected as administrative expenses. 11 U.S.C. §§ 503, 507. The automatic stay generally does not prohibit a city from commencing or continuing an action or proceeding to enforce the city's police or regulatory power. 11 U.S.C. § 362(b)(4); but see Island Club Marina Ltd. v. Lee County, 38 Bankr. 847 (1984) (building permit is an asset of the debtor and can not be revoked while the debtor is in bankruptcy). Although a city may enforce its police or regulatory powers, it may not be able to recover the costs incurred in that action in light of the automatic stay provisions, 11 U.S.C. § 362(b)(5).

Bankruptcy does not discharge or stay criminal restitution debts owed to cities or affect criminal actions. Kelly v. Robinson, 479 U.S. 36, 107 S. Ct. 353, 93 L. Ed. 2d 216 (1986); People v. Goebel, 195 Cal. App. 3d 418, 238 Cal. Rptr. 242 (1987).

g. PROPOSITION 218

(1) IN GENERAL

Proposition 218 creates a special sub-set of fees and charges. It does so by using the term fee or charge to mean a "levy . . . imposed on a parcel or upon a person as an incident of property ownership . . . for property-related service." See Cal. Const. art. XIIID, § 2(e). Proposition 218 also creates certain procedural requirements relating to both fees and charges. See Cal. Const. art. XIIID, § 6. Those procedural requirements include a requirement of notice to property owners of new or increased property-related fees and a mechanism for rejecting such fees via a "majority protest" at a public hearing. In addition, except for sewer, water and refuse collection services, fees which are imposed as an incident of property ownership or property related service require a majority vote of property owners or, at the public agency's option, a two-thirds vote of the general electorate. Finally, Proposition 218 prohibits local agencies from using fees imposed as an incident of property ownership to fund general governmental services, including, but not limited to, fees for police, fire, ambulance or library services which are available to the public at large in substantially the same manner as they are to property owners.

PRACTICE TIP: The League of California Cities has published an implementation guide on Proposition 218 (2000 edition). Copies of the guide are available through the League. For more information contact the League's publication unit at 1400 K Street, 4th Floor, Sacramento, CA 95814, 916/658-8257, FAX 916/658-8220.

(2) FEES AND CHARGES IMPOSED AS AN INCIDENT OF PROPERTY OWNERSHIP

(a) DEFINITIONS. The phrase "property-related fees and charges" appears in the title of California Constitution article XIIID, section 6 and in section 6(c) (relating to voter approval). However, the phrase is not defined anywhere in Proposition 218. Proposition 218 does, however, define the following:

i) "Fee" or "charge" means any levy other than ad valorem tax, a special tax or an assessment imposed by an agency upon a parcel or upon a person as an incident of property ownership, including user fees or charges for property-related services. See Cal. Const. art. XIIID, § 2(e).

ii) "Property ownership" shall be deemed to include tenancies of real property where tenants are directly liable to pay the assessment, fee or charge in question. Cal. Const. art. XIIID, § 2(g).

iii) "Property-related service" means a public service having a direct relationship to property ownership. See Cal. Const. art. XIIID, § 2(h).

(b) APPLICATION. To determine whether a public agency's fee/charge is imposed on a parcel or on a person as an incident of property ownership, Proposition 218 provides the following: "Reliance by an agency on any parcel map, including but not limited to assessor's parcel map may be considered a significant factor in determining whether a fee or charge is imposed as an incident of property ownership for purposes of article XIIID." Cal. Const. art XIIID, § 6(b)(5). See Apartment Assn. of Los Angeles County, Inc. v. City of Los Angeles, 24 Cal. 4th 830, 102 Cal. Rptr. 2d 719 (2001) (concluding city ordinance imposing inspection fee on apartment owners does not violate article XIIID); 80 Cal. Op. Att'y Gen. 183 (1997) (concluding that tiered water rates based upon usage are not property related fees as defined in Cal. Const. art. XIIID, § 6(b)).

PRACTICE TIP: The following guidelines may be helpful to practitioners in determining whether a fee or charge is subject to the provisions of Proposition 218:

1) A fee or charge may be subject to Proposition 218 if it must be paid by a person simply as a result of property ownership and for no other reason (for example, requesting service from a public agency).

2) If a property owner cannot avoid payment of the fee or charge by declining the service for which a fee or charge is paid, the fee or charge is most likely subject to Proposition 218.

3) The fee or charge is subject to Proposition 218 if the fee or charge may be a lien or charge on the parcel from the creation of the fee or charge, as distinguished from being a lien on the parcel only in the event of a default in payment.

(3) SUBSTANTIVE RESTRICTION ON PROPERTY-RELATED FEES AND CHARGES

Property-related fees and charges must meet all of the following requirements:

(a) Revenue derived from the fee or charge must not exceed the funds required to provide the property-related service.

(b) Revenue from the fee or charge must not be used for any purpose other than that for which the fee or charge was imposed.

(c) The amount of the fee or charge imposed upon any parcel or person as an incident of property ownership must not exceed the proportional cost of the service attributable to the parcel.

(d) The fee or charge may not be imposed for service unless the service is actually used by or immediately available to the owner of the property in question. Fees or charges based upon potential or future use of a service are not permitted. Stand-by charges must be classified as assessments and must not be imposed without compliance with the proportionality requirements for assessments.

(e) No fee or charge may be imposed for general governmental service such as police, fire, ambulance or libraries where the service is available to the public in substantially the same manner.

See Cal. Const. art. XIIID, § 6(b); 81 Cal. Op. Att'y Gen. 104 (1998) (concluding storm drainage fee imposed only on users of sewer was a disproportionate cost burden).

(4) BURDEN OF PROOF

In any legal action protesting the validity of a fee or charge, the burden is on the agency to demonstrate compliance with Proposition 218. See Cal. Const. art. XIIID, § 6(b)(5).

(5) PROCEDURAL REQUIREMENTS

(a) NOTICE REQUIREMENTS. A local agency must take the following steps in order to impose a property-related fee or charge:

i) The agency must identify the parcels upon which a fee or charge is proposed for imposition. Cal. Const. art. XIIID, § 6(a)(1).

ii) The amount of the fee or charge proposed to be imposed upon each parcel must be calculated by the agency. Cal. Const. art. XIIID, § 6(a)(1).

iii) The agency must provide written notice by mail of the proposed fee or charge to the record owner of each identified parcel upon which the fee or charge is proposed for imposition. Cal. Const. art. XIIID, § 6(a)(1). Cal. Gov't Code §§ 53750 (i) and (j).

iv) The notice to record owners of property must contain all of the following:

a) The amount of the fee or charge proposed to be imposed upon each parcel; and

b) The basis on which the amount of the proposed fee or charge was calculated; and

c) The reason for the fee or charge; and

d) The date, time and location of a public hearing on the proposed fee or charge.

Cal. Const. art. XIIID, § 6(a)(1).

(b) HEARING REQUIREMENTS. The local agency must conduct a public hearing on the proposed fee or charge at least 45 days after mailing the notice described above. The hearing is to be conducted in the following manner:

i) At the public hearing, the agency must consider all written protests against the fee or charge.

ii) If a written protest against a proposed fee or charge is presented by a majority of owners of the identified parcels, the agency may not impose the fee or charge.

Cal. Const. art. XIIID, § 6(a)(2).

(6) VOTER APPROVAL REQUIREMENTS

(a) NEW OR INCREASED FEES AND CHARGES. New or increased fees and charges subject to Proposition 218, except for sewer, water and refuse collection services, must receive voter approval. See Cal. Const. art. XIIID, § 6(c). Government Code section 53750(h) sets forth when an existing fee is deemed an "increase" for purposes of California Constitution article XIIID, section 6(c).

(b) PROCEDURAL REQUIREMENTS. An election to approve new fees and charges must be conducted not less than 45 days after the public hearing. Cal. Const. art. XIIID, § 6(c). Proposition 218 does not specify procedures for the conduct of the property-related fees and charges election. However, the agency may adopt procedures that are similar to those required for assessments. See Cal. Const. art. XIIID, § 6(c); Cal. Const. art. XIIID, § 4; Cal. Elec. Code § 4000(c) (9) (allowing election to be conducted by mail).

(c) VOTING REQUIREMENTS. The agency has two options with respect to who is allowed to vote in the property-related fees and charges elections:

i) A property owner vote which requires a majority vote of approval.

ii) A two-thirds vote of the electorate residing in the affected area.

See Cal. Const. art. XIIID, § 6(c).

(7) EFFECTIVE DATE

Proposition 218 provides that "[b]eginning July 1, 1997, all fees and charges shall comply with this section." (Emphasis added.) See Cal. Const. art. XIIID, § 6(d). However, if a fee or charge was established prior to the adoption of Proposition 218 and is not ". . . increased or extended," it is exempt from the provisions of Proposition 218. See Cal. Const. art. XIIID, §§ 6(a), (c).

(8) EXEMPTIONS

Proposition 218 specifically excludes two kinds of fees from its provisions:

(a) DEVELOPMENT FEES. Proposition 218 does not affect existing laws relating to the imposition of fees and charges as a condition to property development. See Cal. Const. art. XIIID, § 1(b); Cal. Gov't Code § 66000.

(b) ELECTRICAL AND GAS SERVICES. Proposition 218 provides that fees or charges imposed for the provision of electrical and gas services are excluded from the category of "charges or fees imposed as an incident of property ownership." See Cal. Const. art. XIIID, § 3(b).

h. OTHER HANDBOOK REFERENCE

For related material, please see the following section of this handbook:

(1) IV.C.5.: Public Property, Public Works and Public Utilities, Operation of Utilities, Transit and Public Utilities, Franchises and Utilities.

7. STATE SUBVENTIONS

a. SHARED REVENUE

Various taxes and fees are levied by the state and county governments and are "subvened" to the cities. These subventions are authorized by the state constitution. These include:

(1) Cigarette and Tobacco Products Tax, see Cal. Rev. & Tax. Code §§ 30001 et seq.;

(2) Motor Vehicle License Fees, see Cal. Rev. & Tax. Code §§ 10701 et seq.;

(3) Liquor License Fees, see Cal. Bus. & Prof. Code §§ 23300 et seq.; and

(4) Motor Vehicle Fuel Tax, see Cal. Rev. & Tax. Code §§ 7301 et seq.

b. TAX REIMBURSEMENTS

Local entities are reimbursed for revenue lost as a result of various tax exemptions and reductions, such as the homeowners' property tax exemption, see Cal. Const. art. XIII, § 25, and the reduction of property tax on certain open space lands, see Cal. Gov't Code §§ 16140 et seq.

c. TAX COLLECTION SERVICES

Several taxes are collected by the state and counties on behalf of cities and transferred to the cities. These include:

(1) Local share of real property taxes, see Cal. Rev. & Tax. Code §§ 95 et seq.; and

(2) Sales tax revenues, see Cal. Rev. & Tax. Code § 7200.

The fact another agency collects a tax on behalf of a city does not give that agency the right to withhold the collected taxes, or require an appropriation in order for that agency to remit the monies to the city. However, subject to certain procedural requirements and resolution of pertinent disputes, an agency can offset against the amount of taxes it has collected for a city the amount owed to the agency for services it has rendered. See, e.g., Cal. Gov't Code § 907.

8. GRANTS

a. IN GENERAL

Cities often receive funds from various state and federal grants. Ordinarily, these funds must be used only for the purpose of carrying out the specific state or federal program. For example, federal Community Development Block Grants (CDBG), see 24 C.F.R. §§ 570 et seq., provide for the development of viable urban communities, decent housing and suitable living environments and the expansion of economic development opportunities.

b. OTHER HANDBOOK REFERENCES

For related material, please see the following sections of this handbook:

(1) I.G.1.b.: Municipal Organization and Reorganization, Intergovernmental Relations, Federal, Federal and State Grants;

(2) II.H.5.a.(15) and (16): Internal Organization and Operation, Personnel, Practices and Procedures, Drug Testing, Drug-Free Workplace;

(3) II.H.6.a.(5): Internal Organization and Operation, Personnel, Discrimination, Federal Laws, Rehabilitation Act of 1973;

(4) II.H.6.b.(5): Internal Organization and Operation, Personnel, Discrimination, State Laws, Government Code section 11135; and

(5) IV.B.9. and 10.(c): Public Property, Public Works and Public Utilities, Public Works, Federally-Funded Projects.

9. GIFTS

a. GENERAL AUTHORITY TO ACCEPT

A city may accept or reject any gift, bequest, or devise made to or for the city, or to or for any of its officers in their official capacities or in trust for any public purpose. Cal. Gov't Code § 37354. If such a gift, bequest or devise does not limit the uses to which the property received or the income or increase from it may be put, it may be put to any uses the city desires. Cal. Gov't Code § 37355. There are Political Reform Act consequences which flow from the decision as to whether the gift is to the city or to an official. See Cal. Code of Regulations, title 2, §§ 18944, 18944.1 and 18944.2.

b. CHARTER CITIES

Acceptance of gifts may be regulated and limited by charter provisions. See, e.g., Egan v. City and County of San Francisco, 165 Cal. 576, 585, 133 P. 294 (1913). A gift is void if the conditions attached to it violate a charter provision. O'Melveny v. Griffith, 178 Cal. 1, 171 P. 934 (1918).

c. OTHER HANDBOOK REFERENCE

For related material, please see the following section of this handbook:

(1) IV.A.1.a.(6): Public Property, Public Works and Public Utilities, Public Property, Acquisitions, Gifts.

10. STATE-MANDATED COST REIMBURSEMENT

a. BASIC OBLIGATION

(1) CONSTITUTIONAL EXPRESSION

Whenever the legislature or any state agency mandates a new program or higher level of service on any local government, the state must provide a subvention of funds to reimburse local government for the costs of such program or increased level of service. See Cal. Const. art. XIIIB, § 6. This requirement was enacted as part of Proposition 4 in 1979 and was effective July 1, 1980. See Los Angeles Unified School District v. State of California, 229 Cal. App. 3d 552, 280 Cal. Rptr. 237 (1991) (regarding reimbursability of Cal-OSHA regulations).

(2) STATUTORY EXPRESSION

(a) OVERVIEW. Sections 17500 through 17630 of the California Government Code implement section 6 of article XIIIB of the California Constitution. These provisions set out intent, Cal. Gov't Code § 17500, adopt definitions, Cal. Gov't Code §§ 17510 - 17524, establish and empower the Commission on State Mandates, Cal. Gov't Code §§ 17525 - 17532, establish Commission procedures for handling claims, Cal. Gov't Code §§ 17550 - 17571, establish a procedure for legislative determinations, Cal. Gov't Code §§ 17575-17581, provide method for payment of claims, Cal. Gov't Code §§ 17600 - 17616, and establish an apportionment system, Cal. Gov't Code §§ 17615 - 17616. The California Revenue and Taxation Code previously contained all of the relevant "SB-90" provisions. Chapter 879 of the Laws of 1986 transferred almost all of the operative provisions to the California Government Code. See Cal. Rev. & Tax. Code §§ 2202 - 2246.2.

(b) "COSTS MANDATED BY THE STATE." "Costs mandated by the state" means any increased costs which a local agency or school district is required to incur after July 1, 1980, as a result of any statute enacted on or after January 1, 1975, which mandates a new program or higher level of service of an existing program within the meaning of section 6 of article XIIIB of the California Constitution. Cal. Gov't Code § 17514.

b. INTENT AND SCOPE

(1) TAXPAYER PROTECTION

The reimbursement requirement was intended to provide permanent protection for taxpayers from excessive taxation and a reasonable way to provide discipline in tax spending at state and local levels. County of Fresno v. State of California, 53 Cal. 3d 482, 486, 280 Cal. Rptr. 92 (1991).

(2) SHIFTING OF FINANCIAL RESPONSIBILITY

The voters intended to preclude the state from shifting financial responsibility for carrying out governmental functions onto local entities that were ill-equipped to handle the task. County of Fresno v. State of California, 53 Cal. 3d at 487. But cf. County of Sonoma v. Comission on State Mandates, 84 Cal. App. 4th 1264, 101 Cal. Rptr. 2d 784 (2000) (county sought reimbursement of property tax revenues that were shifted away from local governments and placed into Educational Revenue Augmentation Funds (ERAFs) for distribution to school districts). The court found that local agencies were not entitled to reimbursement for the following reasons: (a) the decrease in revenue suffered by local agencies was not a reimbursable "cost" because the funds were reallocated, rather then actually expended by the local agency; and (b) the state did not impose a "new program or higher level of service" because at the time the obligation became effective, the local agencies jointly funded schools with the state.

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(3) UNIQUE REQUIREMENTS ON LOCAL GOVERNMENT

The courts have "clarified" the definition of "mandate" by determining the state must reimburse only for costs of mandated programs which provide services to the public or which impose unique requirements on local governments; there is no reimbursement for laws which apply generally to all state residents or entities. County of Los Angeles v. State of California, 43 Cal. 3d 46, 233 Cal. Rptr. 38 (1987) (worker's compensation).

c. EXCEPTIONS

(1) CONSTITUTIONAL

The legislature may, but need not, reimburse local governments for the following mandates:

(a) Legislative mandates requested by the local agency affected;

(b) Legislation defining a new crime or changing an existing definition of crime; or

(c) Legislative mandates enacted prior to January 1, 1975, or executive orders or regulations initially implementing legislation enacted prior to January 1, 1975.

See Cal. Const. art. XIIIB, § 6.

(2) STATUTORY

The legislature has also directed the Commission on State Mandates to find no mandate under the following circumstances:

(a) The claim is submitted by a local agency or school district which requested the authority to implement the program specified in the statute;

(b) The executive order or statute "affirmed for the state that which had been declared existing law or regulation by action of the courts";

(c) The statute or executive order implements federal law, unless the statute or order mandates costs which exceed the mandate in the federal law;

(d) The local agency or school district has authority to levy service charges, fees or assessments sufficient to pay for the mandated program or increased level of service;

(e) The statute or executive order provides for offsetting savings to local agencies or school districts which result in no net costs or includes additional revenue specifically intended to fund the costs of the mandate;

(f) The statute or executive order imposes duties which were expressly included in a ballot measure approved by the voters in a statewide election; or

(g) The statute created a new crime or infraction, eliminated a crime or infraction, or changed the penalty for a crime or infraction.

Cal. Gov't Code § 17556. The exception for federal programs applies not only to direct federal mandates but programs which are technically voluntary but coercive in nature which the state passes on to local governments. See City of Sacramento v. State of California, 50 Cal. 3d 51, 266 Cal. Rptr. 139 (1990) (unemployment insurance). The fee "exception" has been upheld on the theory the reference to "costs" excludes expenses which are recoverable from sources other than taxes. County of Fresno v. Superior Court, 53 Cal. 3d 482, 280 Cal. Rptr. 92 (1991).

d. THE LEGISLATIVE PROCESS AND MANDATES

(1) LEGISLATIVE COUNSEL

In drafting a bill, Legislative Counsel determines whether the bill contains a mandate; if so, this must be stated in the Legislative Counsel digest of the bill. Cal. Gov't Code § 17575. Legislative Counsel's determination is not binding on the Commission on State Mandates in its determination on a claim. Id.; City of San Jose v. State of California, 45 Cal. App. 4th 1802, 1817, 53 Cal. Rptr. 2d 521 (1996).

(2) FISCAL COMMITTEES

If a bill contains a mandate, it must be referred to fiscal committees, where committee staff, Department of Finance and Legislative Analyst determine the bill's effect on local governments. See Cal. Gov't Code §§ 17576 - 17577.

(3) REIMBURSEMENT PROVISIONS

If a bill contains a mandate, it must contain reimbursement provisions; the bill can also state there is no mandate or the mandate is being disclaimed and why. Cal. Gov't Code § 17579. If the bill states there is no mandate, the agency must file a test claim with the Commission on State Mandates to challenge such determination. See section VII.A.10.e. of this handbook.

(4) FUNDED VERSUS UNFUNDED MANDATES

(a) IN GENERAL. Mandates will be either funded or unfunded by the legislature. An "unfunded mandate" is a mandate for which the legislature has not made an appropriation. See Cal. Gov't Code § 17579.

(b) FUNDED MANDATES. Agencies must file a "reimbursement claim" with the Controller. See Cal. Gov't Code § 17610. See also Cal. Gov't Code § 17579.

(c) UNFUNDED MANDATES. The state may suspend mandates as part of its budget process. See Cal. Gov't Code § 17581. A local agency is not required to give effect to or implement any statute, executive order (or portion thereof) which has been determined to be a reimbursable mandate if that statute or executive order (or portion thereof) has been identified in the state's budget act as being one for which reimbursement is not being provided for that fiscal year. Id. The specific mandates suspended may vary from year to year. See also Carmel Valley Fire Protection Dist. v. State of California, 25 Cal. 4th 287, 105 Cal. Rptr. 2d 636 (2001) (section 17581 and certain budget measures suspending the operation of administrative regulations did not violate the separation of powers clause of the California Constitution by encroaching on the power of the executive branch of government).

e. ADMINISTRATIVE PROCEDURES

(1) COMMISSION ON STATE MANDATES

(a) REGULATIONS. Title 2 of the California Code of Regulations, sections 1181 to 1189.10, govern test claim rules and establish detailed hearing procedures. Test claims can be referred to hearing officers to establish a record.

(b) COMPOSITION. The Commission on State Mandates is comprised of the following state officials: the Director of Finance, Treasurer, Controller and Director of Planning and Research. In addition, the Commission has a public member appointed by the Governor, and two other members appointed by the Governor from among three categories: a city council member; a county supervisor; or a school board member, but no more than one member can come from any single category. Cal. Gov't Code § 17525.

(c) TEST CLAIM PROCESS. The claim must be filed in the proper form. The Commission seeks state agency input and the claimant is given the right to rebut. The Commission holds a hearing, makes findings and issues a decision. If a mandate is found, the Commission then establishes parameters and guidelines for seeking reimbursement. The Commission makes a statewide cost estimate; it then prepares and submits a claim bill to the legislature for appropriation, if the estimated cost is more than $1 million. If the estimated cost does not exceed $1 million, the Controller is authorized to pay from the State Mandates Claim Fund. Cal. Gov't Code §§ 17550 et seq.

(2) CONTROLLER'S CLAIMING INSTRUCTIONS

"Claiming instructions" are issued by the Controller for each established mandate. They are not regulations. The instructions will track the Commission's parameters and guidelines for the mandate, if they exist. If no parameters and guidelines exist, the Controller will develop the instructions. See Cal. Gov't Code § 17558. See also Cal. Gov't Code §§ 17615 et seq. (apportionment system).

(3) EXCLUSIVE REMEDY

These procedures are the sole and exclusive procedure by which a local agency or school district may claim reimbursement for state-mandated costs. Cal. Gov't Code § 17552. See also Contra Costa, et al. v. State of California, 177 Cal. App. 3d 62, 222 Cal. Rptr. 750 (1986) (required local agencies to exhaust administrative remedies before Commission prior to bringing court action).

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f. JUDICIAL REVIEW

(1) OF COMMISSION ACTIONS

The commission may order reconsideration on petition by either party within 30 days after delivery or mailing of the commission's statement of decision. It is not clear whether filing of a petition for reconsideration is a required administrative procedure preparatory to commencing judicial action. A claimant or the state may seek a writ of mandate to set aside a decision of the Commission on State Mandates on the ground the decision is not supported by substantial evidence. Cal. Gov't Code § 17559. See also Cal. Civ. Proc. Code § 1094.5.

(2) OF LEGISLATURE'S REFUSAL TO FUND MANDATE

If the legislature deletes funding for an established mandate from a local government claims bill, see Cal. Gov't Code § 17612, a local agency or school district may file for declaratory relief in superior court; the declaratory relief declares the mandate unenforceable and enjoins its enforcement. Cal. Gov't Code § 17612. See also Carmel Valley Fire Protection District v. State of California, 190 Cal. App. 3d 521, 234 Cal. Rptr. 795 (1987) (established set of remedies for local agencies prevailing on these cases; remedies include: declaration of unconstitutionality, interest, and reimbursement from funds already appropriated by the legislature for another purpose). But see Carmel Valley Fire Protection Dist. v. State of California, 25 Cal. 4th 287, 300, 105 Cal. Rptr. 2d 636 (2001) (neither an executive administrative agency nor a court has the power to require the legislature to appropriate money).

g. REFERENCES

(1) HANDBOOK

For related material, please see the following section of this handbook:

(a) I.G.2.b.: Municipal Organization and Reorganization, Intergovernmental Relations, State, State Mandates.

(2) OTHER

(a) County Supervisors Association of California, SB-90 Manual for Local Government (3d ed. 1990) (1100 K Street, Sacramento, California, 95814, 916/327-7500).

(b) County Supervisors Association of California, SB-90 Litigation Report, (5th ed. 1991) (1100 K Street, Sacramento, California, 95814, 916/327-7500).

(c) Commission on State Mandates, Local Government Guide to the Mandate Process (1414 K Street, Suite 315, Sacramento, California, 95814, 916/323-3562).

PRACTICE TIPS:

1. Carefully examine all of the legislative history of a bill, including all committee reports, for indications of the existence of a mandate. Also try to determine whether Legislative Counsel issued any opinion to a legislator or other person on the bill (other than the Legislative Counsel Digest in the bill itself).

2. Seek advice from the Commission on State Mandates' staff regarding procedures, regulations and claim history.

3. Exhaust all available administrative remedies--not just the Commission on State Mandates remedy. For example, if there is a tax refund procedure available, use it; otherwise later in court the Attorney General will claim failure to exhaust an available remedy.

4. Seek advice and information from consulting services such as the League's "Cities SB 90 Service." The telephone numbers are 818/546-0401 (for the south state) and 916/485-8519 (for the north state).

5. Pay close attention to the administrative and judicial filing deadlines.

11. RENTAL OF PROPERTY

A city may lease its real and personal property, such as by allowing advertisements in employee newsletters or on sides of city-owned buses. In deciding whether to raise funds through the latter, attention should be paid to whether the city is creating a new public forum. For material on public forums, please see section V.F. of this handbook (relating to the First Amendment). State law establishes the maximum terms for many types of leases. See, e.g., Cal. Gov't Code §§ 37380 et seq.

B. EXPENDITURES

1. BUDGETS

a. REQUIREMENT

There is no state statutory requirement for cities to adopt a budget. However, cities generally may not incur indebtedness or liability which exceeds in any year the income and revenue anticipated for that year without two-thirds voter approval. See Cal. Const. art. XVI, § 18. Adopting a budget enables cities to plan expenditures to match anticipated revenues.

b. TERMINOLOGY

A budget appropriates all monies of the city into different funds for subsequent expenditures. The city may establish separate funds for different purposes, so long as it does not do so contrary to statute or charter. An appropriation is an authorization to expend funds. An expenditure is the actual payment of the funds for the authorized purpose. If an expenditure is required which differs from the budget, an amended appropriation is required.

c. GENERAL VERSUS SPECIAL FUNDS

Municipal funds are either general or special. When a city establishes special funds for the payment of a particular class of claims, or for a particular class of expenditures or for a particular purpose, the general rule is they cannot be used for any other purpose. Long Beach v. Morse, 31 Cal. 2d 254, 188 P. 2d 17 (1947).

d. TIMING

When required by ordinance or charter, a city must adopt a budget before the beginning of every fiscal year, estimating the city's future expenditures and revenues.

e. FILING WITH COUNTY AUDITOR

Unless exempted by the county auditor, a city must file a copy of its budget within 60 days after the beginning of its fiscal year with the auditor. Cal. Gov't Code §§ 53734, 53901; Newton v. Brodie, 107 Cal. App. 512, 290 P. 1058 (1930).

f. JUDICIAL REVIEW

Because the adoption of a budget is a legislative function, a court is generally without power to interfere in the budgetary process.

2. INVESTMENTS

a. PERMITTED INVESTMENTS

(1) IN GENERAL

State law permits a city having money in its treasury not required for its immediate needs to make the following investments:

(a) the city's own bonds;

(b) United States Treasury bills, notes and bonds;

(c) registered state warrants;

(d) other California local agency bonds;

(e) bank issues based on federal obligations;

(f) commercial bank time drafts (bankers' acceptances);

(g) prime quality (highest letter and numerical rating by Moody's, Standard and Poor's or Fitch) commercial paper;

(h) negotiable certificates of deposits (CDS);

(i) repurchase or reverse repurchase agreements for authorized investments (reverse repurchase agreements made after December 31, 1994 are subject to substantial restrictions and require prior approval of the city council);

(j) "A" rated medium-term corporate notes;

(k) shares of beneficial interest issued by diversified management companies investing in previously authorized investments;

(l) investments in accordance with the statutory provisions regarding issuance of bonds if monies are held by trustee or fiscal agent (this is an allowable investment for the city treasurer notwithstanding the provisions of California Government Code section 53635);

(m) notes or bonds secured by first priority security interest (eligible securities) of the type listed in California Government Code section 53651; and

(n) any mortgage pass-through security, collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-backed certificate, consumer receivable pass-through certificate or consumer receivable-backed bond of a maximum five year maturity, from "A" rated issuers.

See Cal. Gov't Code § 53601. Purchased securities must be physically delivered to the purchasing city or to a bank trust department. See Cal. Gov't Code § 53601.

(2) CHARTER CITIES

Charter cities have plenary authority over "municipal affairs." See Cal. Const. art. XI, § 5. Traditionally, charter city financing has been a matter of local concern so charter cities have been able to set up their own investment policies and programs independent from the state. A charter city would only be constrained by basic constitutional limitations. However, in the rare instance where a city charter might omit any mention of specific investing or financing procedures, it appears the general laws would govern such procedures. McLeod v. Board of Pension Commissioners, 14 Cal. App. 3d 23, 94 Cal. Rptr. 58 (1970).

(3) LOCAL AGENCY INVESTMENT FUND

The Local Agency Investment Fund (LAIF) is a special fund in the state treasury created by state law. See generally Cal. Gov't Code §§ 16429.1 et seq. This law permits a local government official, with consent of the governing body of that agency, to remit money in its treasury not required for immediate need to the state treasurer for deposit in this fund for investment purposes. Investment in the LAIF allows a city to choose the length of time its money will remain in the fund. Interest on the deposit is paid at the end of each quarter and the fees charged by the LAIF are limited to one-quarter of one percent of the earnings of the fund. To obtain further information contact the Investment Division of the state treasurer's office (916/653-3147).

b. INVESTMENT POLICY

(1) POLICY CONTENTS

A city is not required to approve the full range of investments allowed by state law. See Cal. Gov't Code § 53601. The city council should work with the city treasurer or other official in determining what range of investments the policy should allow. For example, small cities may find it appropriate to limit city investments to passbook savings accounts, CDS, T-bills, etc. The investment policy will vary depending on the budget size, investment sophistication and other characteristics of each city. The city should also evaluate the LAIF. The city may also specify the percentage of funds that may be invested in securities of various maturities. The California Municipal Treasurers Association has drafted a form investment policy that may assist a city in adopting its own policy.

(2) PRUDENT INVESTMENT STANDARD

A city must invest its funds as a trustee acting in accordance with the prudent investment standard. See Cal. Gov't Code § 53600.3.

c. INVESTMENT AUTHORITY

(1) CITY COUNCIL

A city council may invest city funds not required for its immediate needs. See Cal. Gov't Code § 53601 (listing permissible investments). A city council may annually delegate this investment authority to its duly-appointed city treasurer by ordinance or resolution. See Cal. Gov't Code § 53607. If a city delegates investment authority to the city treasurer, the treasurer must make a monthly report of any investment transactions to the city council. Cal. Gov't Code § 53607.

(2) CITY TREASURER

The city treasurer is responsible for the safe deposit of all moneys in the custody of the city. See Cal. Gov't Code § 53635. In addition, the city treasurer must annually render to the city council (or any investment committee created by the city council) a statement of investment policy to be considered by the city council at a public meeting. See Cal. Gov't Code § 53646(a)(2).

(3) CITY MANAGER

A city's code usually lists the duties of the city manager. These duties normally require the city manager to supervise and administer all departments and personnel within the city.

d. REPORTING REQUIREMENTS

The city treasurer is required to give certain reports on investments to the legislative body, and under certain circumstances to the California Debt and Investment Advisory Commission. Cal. Gov't Code § 53646.

PRACTICE TIPS:

1. Experts disagree about whether investment authority can be delegated to an official other than the treasurer, even though the delegee may be the treasurer's supervisor.

2. If such delegation is necessary or desirable in a specific case, the city council should articulate explicitly the city manager has the duty and authority to invest city funds. A city manager may have investment authority under California Government Code section 53635 if he or she is authorized by the city to receive payment of any moneys. However, such a delegation would be subject to the restrictions on incompatible offices and holding dual offices. See People ex rel Chapman v. Rapsey, 16 Cal. 2d 636, 107 P. 2d 388 (1940); 22 Cal. Op. Att'y Gen. 83 (1953).

(1) DEPOSITS

Cities may make three types of deposits: (1) inactive, (2) active, and (3) interest-bearing active. Cal. Gov't Code § 53632. Active deposits are deposits that are payable on demand. Inactive deposits are all those deposits that are not active. Any deposits made by the treasurer of a city are subject to state law restrictions administered and enforced by the Local Agency Deposit Security Administration. See generally Cal. Gov't Code §§ 53630 - 53692; 2 Cal. Code Regs. §§ 16001.1.1 - 16010.1.3.

3. APPROPRIATIONS, WARRANTS AND PAYMENTS

a. APPROPRIATIONS

A specific appropriation is an act by which a named sum of money is set apart in the treasury and devoted to the payment of particular claims or demands. The city may accomplish this by adopting a budget or passing an appropriations ordinance or resolution. If a proposed appropriation exceeds the amount estimated in the budget for such an expenditure, the city council should amend the budget to allow for such an appropriation. An appropriation may not be expended for anything other than a public purpose. Appropriations for a particular purpose cannot be used for a different purpose. Rancho Santa Anita, Inc. v. Arcadia, 20 Cal. 2d 319, 125 P.2d 475 (1942). See section VII.B.5. of this handbook for further information on expenditures and limitations.

b. WARRANTS AND PAYMENTS

(1) THE WARRANT PROCESS

California cities are authorized to pay out funds from their accounts through the warrant process. A warrant is an order by which the drawer, usually the city council or city treasurer, authorizes the bank or other depository of city funds to pay a particular sum of money. A city may use facsimile signatures for any instrument of payment after filing a certification pursuant to Government Code section 5501. If funds are available for the payment of an approved claim, the warrant becomes a check directing the bank or depository of city funds to pay the funds to the payee. When funds are unavailable, the warrant becomes an interest-bearing municipal obligation. Cal. Gov't Code § 53911. See generally Cal. Gov't Code §§ 53910 - 53914.

(2) LOCAL PRACTICES

A city may adopt such further practices with respect to payment of warrants as it deems convenient, efficient and in the public interest. Cal. Gov't Code § 53910. To avoid city council approval of every minor equipment purchase or service payment, a city council often will delegate payment authority to certain city personnel, allowing them to authorize payment of a claim from a particular budget account. So long as the budget provides for such a payment, the city employee may authorize payment without city council approval. Usually, the city council will retain authority to approve payments exceeding a certain amount.

4. LIMITATIONS

a. MUNICIPAL PURPOSE DOCTRINE

(1) GIFTS OF PUBLIC FUNDS PROHIBITED

The legislature has no power to authorize a city to "... make ... any gift of any public money or thing of value to any individual, municipal or other corporation whatever ... " Cal. Const. art. XVI, § 6. Since each charter city derives its powers from a charter under the constitution, rather than the legislature, this section does not apply to charter cities. Gift prohibitions may, however, be included in a city's charter.

(2) GIFT VERSUS PUBLIC PURPOSE

(a) IN GENERAL. In determining whether an appropriation of public funds or property is to be considered a gift, the two primary questions are whether the funds are to be used for a "public" or a "private" purpose and whether these are to be used for a public purpose of the agency making the expenditure. If they are for a "public" purpose of the city making the expenditure, they are not a gift within the meaning of section 6, article XVI of the constitution. County of Alameda v. Janssen, 16 Cal. 2d. 276, 106 P. 2d 11 (1940).

(b) INCIDENTAL BENEFITS TO PRIVATE INDIVIDUALS. A mere incidental benefit to an individual does not make a "public" purpose a "private" purpose. American Company v. City of Lakeport, 220 Cal. 548, 32 P. 2d 622 (1934).

(c) JUDICIAL REVIEW. The determination of what constitutes a "public" purpose is primarily a matter for the legislature and its discretion will not be disturbed by the courts so long as the determination has a reasonable basis. Board of Supervisors of City and County of San Francisco v. Dolan, 45 Cal. App. 3d 237, 119 Cal. Rptr. 347 (1975).

(d) SPECIFIC EXAMPLES.

i) RETIREMENT ALLOWANCES. The gift-of-public-funds prohibition does not prohibit the payment of pensions, even when granted retroactively. See City of Downey v. Board of Administration, 47 Cal. App. 3d 621, 121 Cal. Rptr. 295 (1975).

ii)) HOUSING. Transfer of land from a housing authority to a private corporation for construction of a low and moderate income housing project is not a gift of public funds. Winkelman v. City of Tiburon, 32 Cal. App. 3d 834, 108 Cal. Rptr. 415 (1973).

iii) PUBLIC ASSISTANCE. Proposed bond issue for the relief of indigent sick and poor is not a gift of public funds. San Francisco v. Collins, 216 Cal. 187, 13 P.2d 912 (1932).

iv) SETTLEMENT AGREEMENTS. When funds are expended pursuant to a settlement agreement in exchange for relinquishment of a wholly invalid claim, no "public" purpose is achieved. Orange County Foundation v. Irvine Company, 139 Cal. App. 3d 195, 188 Cal. Rptr. 552 (1983).

v) PAYMENTS TO OTHER AGENCIES. Payments of city funds to other public agencies for their purposes (with no benefit flowing back to the city and its citizens) is not a valid expense and is a gift of public funds. See Golden Gate Bridge and Highway District v. Luehring, 4 Cal. App. 3d 204, 84 Cal. Rptr. 291 (1970); Santa Barbara County Water Agency v. All Persons and Parties, 47 Cal. 2d 699, 306 P.2d 875 (1957), rev'd on other grounds Ivanhoe Irrigation District v. McCracken, 357 U.S. 275, 78 S. Ct. 1174 (1958); Oakland v. Garrison, 194 Cal. 298, 228 P. 433 (1924); Ojai v. Chaffee, 60 Cal. App. 2d 54, 140 P. 2d 116 (1943); but see White v. State of California, 88 Cal. App. 4th 298, 105 Cal. Rptr. 2d 714 (2001) (statutes enacted to assist Orange County in recovering from bankruptcy by reallocating sales and property taxes from Orange County local agencies to the County's general fund were not gifts of public funds; the same general group of taxpayers who paid these taxes will benefit from the transfer).

PRACTICE TIP: An excellent vehicle for articulating the public purpose of a city expenditure is a contract with the recipient of the funds that identifies the public purpose prompting the expenditure as the consideration for making it.

(3) RETROACTIVE COMPENSATION; UNAUTHORIZED AGREEMENTS

The legislature has no power to authorize a city to grant extra compensation to any public officer, public employee or contractor after service has been rendered or to authorize payment of a claim under an agreement made without authority of law. Cal. Const. art. IV, § 17. Since charter cities derive their powers from a charter under the constitution, rather than from the legislature, this section does not apply to charter cities. Similar prohibitions may, however, be included in a city's charter.

PRACTICE TIP: If salary negotiations with employees are likely to extend past a specific date which the city and employees agree should be the start of a new contract, a resolution reserving the right to revise salaries effective as of such date should be adopted prior to that date to avoid the prohibition of California Constitution article IV, section 17.

(4) OTHER HANDBOOK REFERENCE

For related material, please see the following section of this handbook:

(a) I.A.5.b.: Municipal Organization and Reorganization, Introduction, Limits on Municipal Power, Public Purpose.

b. PROPOSITION 4 (GANN LIMIT)

(1) INTRODUCTION

The goal of Proposition 4 was to limit the growth in appropriations of both state and local government to changes in the cost of living and population in order to control spending levels. See generally Cal. Const. art. XIIIB. Proposition 4 also attempted to clarify the fiscal roles played by the various branches and levels of government and to insure any surplus funds were promptly returned to the people. Article XIIIB has been amended twice (Propositions 98 and 99) and again in 1990 (Proposition 111).

(2) CONCEPT

Proposition 4 undertakes to impose appropriations limits (as opposed to taxing limits as provided by Proposition 13). In doing this, Proposition 4 restricts annual appropriations to an amount set by a formula involving a base year with allowable adjustments (increases) based upon increases in population and additions for inflation. The formula is relatively easy to follow, but anomalies can result primarily from exemptions such as state mandates, debt service/indebtedness, treatment of special districts and treatment of certain income as "proceeds of taxes."

(3) STATUTORY PROVISIONS

(a) STATUTORY SCHEME. Article XIIIB was implemented by the legislature in California Government Code sections 7900 through 7914.

(b) ADOPTION OF ANNUAL APPROPRIATIONS LIMIT. Each local agency is required to adopt an "appropriations limit" annually by resolution. Cal. Gov't Code § 7910.

(c) DETERMINATION OF APPROPRIATIONS LIMIT. The appropriations limit is determined by a mathematical calculation which multiplies the "base year" limit by certain enumerated factors. Cal. Gov't Code § 7902.

(d) DISTINGUISHING PROCEEDS OF TAXES. Since only proceeds of taxes are subject to the appropriations limit, attention must be given to what these "proceeds of taxes" do and do not include. See Cal. Gov't Code § 7901(i).

(e) TRANSFER OF SERVICES. An adjustment in each agency's appropriations limit is required when the financial responsibility for providing such services is transferred from one entity to another. Cal. Const. art. XIIIB, § 3(b).

(4) CASE LAW INTERPRETATIONS

(a) STATE AND FEDERAL MANDATES. On the question of federal and state mandates and exactly how they are to be treated under provisions of Proposition 4, City of Sacramento v. State of California, 50 Cal. 3d 51, 266 Cal. Rptr. 139 (1990), says the local costs of providing unemployment insurance coverage were not subject to subvention under Proposition 4 but the "mandate" to bear these costs was a constitutional grant to tax and spend as necessary to pay for the insurance coverage. Two other cases, County of Los Angeles v. State of California, 153 Cal. App. 3d 568, 200 Cal. Rptr. 394 (1984), and County of Los Angeles v. State of California, 43 Cal. 3d 46, 233 Cal. Rptr. 38 (1987), discuss further the concept of state mandates under Proposition 4 and their relationship to mandates calling for reimbursement under the provisions of the California Revenue and Taxation Code (SB 90).

(b) REDEVELOPMENT. Huntington Park Redevelopment Agency v. Martin, 38 Cal. 3d 100, 211 Cal. Rptr. 133 (1985), and Bell Community Redevelopment Agency v. Woosley, 169 Cal. App. 3d 24, 214 Cal. Rptr. 788 (1985), both address the relationship between a municipality and its redevelopment agency as it may relate to an allowable adjustment concerning appropriations limits and the transfer of financial responsibility for a particular program. Bell also spells out some of the nuances in the "bonded indebtedness" exception. Redevelopment Agency of the City of San Marcos v. California Commission on State Mandates, 55 Cal. App. 4th 976, 64 Cal. Rptr. 2d 270 (1997) (held that the twenty percent set-aside required by statute is not a "cost" requiring reimbursement).

(c) ASSESSMENT DISTRICTS. County of Placer v. Corin, 113 Cal. App. 3d 443, 170 Cal. Rptr. 232 (1980), makes it clear assessment districts do not generate revenues which are to be construed as "proceeds of taxes."

(d) PENSION CONTRIBUTIONS. San Francisco Taxpayers Association v. Board of Supervisors, 2 Cal. 4th 571, 7 Cal. Rptr. 2d 245 (1992), holds contributions to employee pension funds are "appropriations subject to limitation" within the meaning of Proposition 4. Cf. Carman v. Alvord, 31 Cal. 3d 318, 182 Cal. Rptr. 506 (1982) (holding under certain conditions a public entity's contribution to a pension fund was an "indebtedness" exempt from the taxing limits of Proposition 13).

(5) REFERENCES

(a) HANDBOOK. For related material, please see the following section of this handbook:

i) I.A.5.d.: Municipal Organization and Reorganization, Introduction, Limits on Municipal Power, Appropriations Limits.

(b) OTHER

i) League of California Cities, Uniform Guidelines For The Implementation of Article XIIIB of The California Constitution (1991); and

ii) Office of the Legislative Analyst, An Analysis of Proposition 4, The Gann "Spirit of 13" Initiative (Report #79-20) (December 1979).

c. DEBT LIMITATION

(1) RESTRICTION

No city may incur any indebtedness exceeding in any year the income and revenues provided for such year without the consent of two-thirds of the qualified electors. Cal. Const. art. XVI, § 18. Cf. Cal. Const. art. XIIIA, § 1, discussed in section VII.A.2.(c)(3) (above) of this handbook, which limits the use of the taxing power to secure indebtedness.

(2) PURPOSES

The purposes of the constitutional debt limitation are three-fold:

(a) To safeguard the general funds and property of a city from a situation in which the holders of an issue of bonds could force an increase in taxes or foreclose on the city's general assets or property, County of Shasta v. County of Trinity, 106 Cal. App. 3d 30, 165 Cal. Rptr. 18 (1980); Redondo Beach v. Taxpayers, Property Owners, Citizens and Electors, 54 Cal. 2d 126, 5 Cal. Rptr. 10 (1960);

(b) To afford the taxpayers an opportunity to express their approval or disapproval of long-term indebtedness, Palm Springs v. Ringwald, 52 Cal. 2d 620, 342 P. 2d 898 (1959); and

(c) To end extravagant expenditures on public improvements, Long Beach v. Lisenby, 180 Cal. 52, 179 P. 198 (1919).

(3) EXCEPTIONS

(a) OBLIGATIONS IMPOSED BY LAW. Debt limitation applies only to debts the city has itself voluntarily incurred, not to those imposed by law. Examples include:

i) Obligation of city to transfer money into a bond redemption fund under Improvement Bond Act of 1915, American Can v. City of Lakeport, 220 Cal. 548, 32 P. 2d 622 (1934);

ii) Obligation of counties to provide adequate facilities for courts, County of Los Angeles v. H. L. Byram, 36 Cal. 2d 694, 227 P.2d 4 (1951);

iii) Obligation of city under California Government Code to provide police and fire protection, City of La Habra v. Pellerin, 216 Cal. App. 2d 99, 30 Cal. Rptr. 752 (1963), cf., however, City of Saratoga v. Huff, 24 Cal. App. 3d 978, 101 Cal. Rptr. 32 (1972); and

iv) Obligation of city to provide for defense of public employee acting within scope of employment, Cal. Gov't Code § 995, and to provide private counsel, see Cal. Gov't Code § 996; Wrynt v. Compton Unified School District, 46 Cal. App. 3d 177, 120 Cal. Rptr. 115 (1975).

(b) SPECIAL FUND DOCTRINE. The special fund doctrine is a judicially-created exception to the debt limitation for debts paid solely out of a special fund and for which the general fund or general tax levies are not liable. City of Redondo Beach v. Taxpayers, Property Owners, Citizens & Electors, etc., 54 Cal. 2d 126, 131-132, 5 Cal. Rptr. 10 (1960). The special fund doctrine may be limited where there is a direct or indirect obligation of the general fund or other loss should the special fund prove insufficient to pay the debt. Garrett v. Swanton, 216 Cal. 220, 13 P. 2d 725 (1932), overruled on other grounds, Oxnard v. Dale, 45 Cal. 2d 729, 290 P. 2d 859 (1955). However, if a debt falls within the scope of the special fund doctrine, discretionary payments from the general fund do not preclude application of the doctrine. Board of Supervisors of the City and County of San Francisco v. Dolan, 45 Cal. App. 3d 237, 119 Cal. Rptr. 347 (1975). Examples of the special fund doctrine include:

i) Revenue bonds to construct improvements to sewer system, City of Oxnard v. Dale, 45 Cal. 2d 729, 290 P. 2d 859 (1955); and

ii) Bonds issued under the Marks-Foran Residential Rehabilitation Act of 1973, Cal. Health & Safety Code §§ 37910 et seq., which by their terms do not obligate general fund or require taxes.

(c) SERVICE CONTRACTS AND LEASES. Debt limitation does not apply to obligations which provide for payments at different times so long as the annual payments do not exceed yearly income and the obligation only arises from year to year in separate amounts as the property or services are furnished. Debt limitation does apply, however, to conditional sales contracts, McFayden v. Town of Calistoga, 74 Cal. App. 378, 240 P. 523 (1925); cf. County of Sacramento v. Assessment Appeals Board, 32 Cal. App. 3d 654, 108 Cal. Rptr. 434 (1973). Examples of long-term obligations held not to constitute debt subject to the limitation include:

i) Lease with an option to buy, when title vests at end of lease term and which creates no immediate indebtedness for aggregate amount of rent, Lagiss v. County of Contra Costa, 223 Cal. App. 2d 77, 35 Cal. Rptr. 450 (1963);

ii) Ground lease of county property with a lease-back to the county after construction of public facilities, County of Los Angeles v. Nesvig, 231 Cal. App. 2d 603, 41 Cal. Rptr. 918 (1965); and

iii) Contract for work done in the future to be paid in installments if the installments payable during the future year do not exceed that year's revenue, Smilie v. Fresno County, 112 Cal. 311, 44 P. 556 (1896); for reconfirmation of prior case law, see Rider v. City of San Diego, 18 Cal. 4th 1035, 77 Cal. Rptr. 2d 189 (1998).

iv) EXCLUDED OBLIGATORS. The debt limitation established by California Constitution article XVI, section 18 only applies to named entities such as cities. It does not apply to a city's redevelopment agency, parking authority or housing authority.

(4) STATUTORY PROVISIONS

In addition to the constitutional debt limitation, the Municipal Improvement Bond Act of 1901 limits the total indebtedness secured by general obligations of the city to a certain percentage of all real and personal property of the city. See generally Cal. Gov't Code §§ 43600 et seq.

(5) MISCELLANEOUS ELECTION ISSUES

(a) WHAT CONSTITUTES "TWO-THIRDS." The requirement of two-thirds voter approval means two-thirds of those voting, not two-thirds of all qualified electors. San Joaquin Light and Power Corporation v. Madera, 175 Cal. 229, 165 P. 701 (1917).

(b) ELECTION TIMING. Although the election must be a special election–one held for the purpose of voting on the indebtedness–it may be consolidated with a general election. Howland v. Board of Supervisors, 109 Cal. 152, 41 P. 864 (1895).

(6) OTHER HANDBOOK REFERENCES

For related material, please see the following sections of this handbook:

(a) I.A.5.c.: Municipal Organization and Reorganization, Introduction, Limits on Municipal Power, Debt Limits.

C. DEBT FINANCING

1. INTRODUCTION

Cities may finance acquisition or construction of various projects and capital assets through the issuance and sale of municipal securities. Securities are sold and the proceeds are used for the cost of such acquisition or construction.

2. BONDS

a. TYPES OF BONDS

Interest on bonds issued by a local government is exempt from state personal income taxes. Cal. Const. art. XIII, § 26. Tax-exempt bonds are typically categorized according to the source of the funds for repayment and generally fall into one of the following categories:

(1) General obligation bonds,

(2) Revenue bonds,

(3) Assessment bonds,

(4) Tax increment bonds, and

(5) Special tax bonds.

Cities may also issue taxable bonds. Taxable bonds are generally issued when a portion of the bond proceeds will be used to finance private activities and are subject to taxation under the Internal Revenue Code of 1986.

b. GENERAL OBLIGATION BONDS

General obligation bonds pledge a city's general funds and "full faith and credit" (i.e., the property taxing power) as security for payment of principal and interest to bond holders. The general framework for issuing such bonds is the Municipal Improvement Bond Act of 1901. See generally Cal. Gov't Code §§ 43600 et seq. Two-thirds voter approval is necessary for the issuance of general obligation bonds and they may be only used to fund the acquisition or improvement of real property. Cal. Const. art. XIIIA, § 1(b), art. XVI § 18; Cal. Gov't Code § 43614.

c. REVENUE BONDS

(1) IN GENERAL

(a) NATURE OF A REVENUE BOND. Revenue bonds pledge a specific source of revenue (e.g., user fees or charges) as security for the bonds. A city does not obligate other funds or revenues for the payment of the bonds. However, the city may elect to make payments from other sources in the event of default.

(b) RELATIONSHIP TO DEBT LIMIT. Typically revenue bond financing avoids the classification as "debt" for purposes of the state constitution since a specific stream of revenues is being pledged and it falls within the "Special Fund" exception to the Constitutional Debt Limit discussed above. Therefore, voter approval is not constitutionally required. City of Santa Clara v. Von Raesfeld, 3 Cal. 3d 239, 90 Cal. Rptr. 8 (1970). See also City of Oxnard v. Dale, 45 Cal. 2d 729, 290 P. 2d 859 (1955); Garrett v. Swanton, 216 Cal. 220, 13 P. 2d 725 (1932), overruled on other grounds, Oxnard v. Dale, 45 Cal. 2d 729, 290 P. 2d 859 (1955); Board of Supervisors of City and County of San Francisco v. Dolan, 45 Cal. App. 3d 237, 119 Cal. Rptr. 347 (1975); Rider v. City of San Diego, 18 Cal. 4th 1035, 77 Cal. Rptr. 2d 189 (1998). For a discussion of the "special fund doctrine," see section VII.B.5.c.(3) of this handbook.

(c) NEED FOR VOTER APPROVAL. There are a number of different statutes which authorize the issuance of revenue bonds in conjunction with certain operations or enterprises. Some of these statutes require an election for the issuance of bonds. The Revenue Bond Act of 1941, discussed below, is commonly used for the issuance of revenue bonds. These statutes, including the Revenue Bond Act of 1941, generally require an approval by a majority of voters for the issuance of revenue bonds.

(2) REVENUE BOND ACT OF 1941

(a) IN GENERAL. Under the Revenue Bond Law of 1941, a city may issue bonds for the acquisition or construction of an enterprise. See generally Cal. Gov't Code §§ 54300 - 54435.

(b) TYPES OF ENTERPRISES COVERED. An enterprise may include garbage collection service, a sewer or water facility, a parking lot, a public hospital, a airport, a harbor or a golf course. See Cal. Gov't Code § 54309. See also Cal. Gov't Code § 54309.1 (scope of enterprise).

(c) ENTERPRISE FUND. After establishing the enterprise, a city would create an enterprise fund in which it would place enterprise revenues. See Cal. Gov't Code § 54519. Such a fund would be managed under the city's budget. The money from this fund secures the payment of the interest on and principal of the bonds. Cal. Gov't Code § 54420. The city may use money from this fund to pay for the maintenance and operation costs of the enterprise. See Cal. Gov't Code §§ 54425, 54426. The city may use any remaining surplus funds from this account, including interest, for any other lawful purpose. Cal. Gov't Code § 54425.

d. ASSESSMENT BONDS

Assessment bonds are issued to finance acquisition or construction of various improvements and are more fully discussed in section VII.A.3. of this handbook on special benefits assessments and districts.

e. TAX INCREMENT BONDS

Tax increment bonds are issued by redevelopment agencies for redevelopment purposes. For a discussion of redevelopment and tax increment financing, please see section V.C.6. of this handbook.

f. SPECIAL TAX BONDS

Pursuant to the Mello-Roos Community Facilities Act of 1982, cities may form community facilities districts to fund public improvements and facilities. Community facilities districts may issue bonds secured by special taxes levied on property within the district. See Cal. Gov't Code §§ 53311 et seq. For information relating to Mello-Roos financing, please see section VII.A.2.b.(3) of this handbook.

3. CERTIFICATES OF PARTICIPATION

a. IN GENERAL

Certificates of participation (COPs) use a tax-exempt lease structure to finance the construction of public facilities or improvements. If structured properly, COPs do not constitute "debt" for purposes of the state constitution. See, e.g., City of Los Angeles v. Offner, 19 Cal. 2d 483, 122 P. 2d 14 (1942); Dean v. Kuchel, 35 Cal. 2d 444, 218 P. 2d 521 (1950). Because COPs often rely upon an annual appropriation from the city's general fund, the interest rate and the cost of financing often depend upon whether the improvements to be financed and the property which is the basis for the underlying lease are essential to the functioning of the city. However, COPs can be used to finance virtually any public improvement or facility. COPs do not require an election, even if the payments are secured by enterprise revenues.

b. FORM

A COP financing typically takes the form of a tax-exempt lease structure. In such a case, a city enters into a lease with a non-profit financing corporation, a public financing authority formed by the city (see discussion infra) or similar entity. The lessor (financing corporation) acquires the site and, with the assistance of the city, undertakes construction of a project to be located on the site. The lessor then leases the improvements to the city pursuant to a financing lease. The lessor's rights to receive payments under that lease are then assigned to a trustee under the terms of a trust agreement. The trustee executes and delivers COPs which evidence rights to participate in those lease payments. The COPs are securities essentially similar to bonds and the lease payments are the security which is pledged for payment of the securities. However, unlike a bond, the COPs are not themselves promissory debt instruments. Instead, they evidence an undivided proportional right of the owner to receive a share of the lease payments (comprised of both principal and interest components) made under the tax-exempt lease.

c. REFERENCES

(1) A.M. Mouton "Certificates of Participation," 1 Land Use Forum 185 (Spring 1992); and

(2) Public Securities Association, A Guide to Certificates of Participation (1991).

4. SALE LEASE-BACK/LEASE-BACK

a. IN GENERAL

Cities may enter into sale lease-back or lease-back agreements either as part of a COP issue as outlined above or as a long-term installment lease obligating a city to make annual payments from its general fund. Bonds issued by a city's public financing authority or a "captive" non-profit corporation may also be issued with the stream of payments made under the lease agreements as the source of repayment.

b. REQUIREMENTS

The important points in any long-term lease-back transaction are three-fold:

(1) Rentals may only be paid to the extent that beneficial use and occupancy of the leased property is available to the city. Rent must be abated when a city does not occupy or have beneficial use of the property.

(2) The obligation of a city to make payments must be on an annual basis and subject to appropriation. Acceleration of rental payments is not permitted. To do otherwise would violate the constitutional debt limitation. A covenant to annually appropriate is common.

(3) Fair market rental, taking into consideration the nature and use of the property and the option to purchase, should be paid for the property.

See generally City of Los Angeles v. Offner, 19 Cal. 2d 483, 122 P. 2d 14 (1942); Dean v. Kuchel, 35 Cal. 2d 444, 218 P. 2d 521 (1950); Krenwinkle v. Los Angeles, 4 Cal. 2d 611, 51 P. 2d 1098 (1935); Ruane v. City of San Diego, 267 Cal. App. 2d 548, 73 Cal. Rptr. 316 (1968); Rider v. City of San Diego, 18 Cal. 4th 1035, 77 Cal. Rptr. 2d 189 (1998).

c. EQUIPMENT LEASES

Equipment leases with a term beyond one fiscal year are subject to the same debt limit considerations as long-term leases of real property. Such leases are also subject to abatement during interruptions in the use of the equipment caused by damage or destruction. An alternative approach is to reserve the unrestricted right to terminate the lease at or prior to the end of each fiscal year. The effect of reserving this right (sometimes referred to as "non-appropriation") is to restrict the lease to a one-year obligation, which is also not subject to the constitutional debt limit. See section VII.B.4.c.(a) of this handbook.

5. PUBLIC FINANCING AUTHORITY BONDS

a. IN GENERAL

The Marks-Roos Local Bond Pooling Act of 1985 provides to a city and its related entities several mechanisms for financing and refinancing principally public capital improvements. See generally, Cal. Gov't Code §§ 6584 et seq. Implementation of these mechanisms requires the formation, pursuant to a joint powers agreement, of a public financing authority, customarily created by a joint powers agreement between the city and its redevelopment agency.

b. USES

A public financing authority is most often used to implement the following financing mechanisms:

(1) BOND POOLING

This mechanism involves the sale of public financing authority bonds and the use of the proceeds to purchase city or redevelopment agency bonds. Repayments of the city or redevelopment agency bonds are used to repay the public financing authority bonds. A common form of bond pooling involves the purchase by the public financing authority of several of a city's special assessment bonds or special tax bonds in order to implement a consistent development program or to accomplish a refinancing of outstanding city bonds.

(2) LEASE AND INSTALLMENT SALE FINANCING

A public financing authority is authorized to issue its bonds for the purposes of financing or refinancing a public capital improvement for lease or installment sale to a city. This is an alternative method of accomplishing the financings described under Certificates of Participation (section VII.C.3.) and Sale-Lease-Back/Lease-Lease-Back (section VII.C.4.) of this handbook, above.

(3) LOANS

A public financing authority is authorized to issue its bonds to provide loans to the redevelopment agency to finance redevelopment activities. This mechanism permits the combining of loans to several redevelopment project areas into one bond issue.

PRACTICE TIPS:

1. Whatever method of financing is sought, it is important to obtain expert advice. The city wants to issue its debt on a tax-exempt basis and, consequently, bond counsel should be retained at an early date to assist the city in preparation of the necessary documents and proceedings to issuance of tax-exempt securities. With Congress increasing the limitations on the issuance of tax-exempt debt, early retention of bond counsel and other experts is a greater necessity.

2. All city council actions relating to borrowing, where the amount is $100,000.00 or more, must be discussed, considered and deliberated upon as a "separate item of business on the agenda." In effect, this means that approvals relating to bond issues in excess of $100,000.00 cannot be on the general consent calendar. Cal. Gov't Code § 53635.7.

D. MUNICIPAL BANKRUPTCY

1. STATUTORY AUTHORITY

a. INTRODUCTION

(1) HISTORICAL BACKGROUND

Prior to the enactment of the Bankruptcy Act of 1934 there was no statutory authority for the filing of a bankruptcy case by a municipality. Before that time, it was believed that the constitutions of the United States and individual states prohibited the enactment of legislation permitting municipal bankruptcies. In the case of the federal government such legislation would violate state sovereignty. Ashton v. Cameron County District, 298 U.S. 513, 531, 56 S. Ct. 892, 80 L. Ed. 1309 (1936). In the case of an individual state, such legislation would violate the restriction that states may not impair contractual obligations. Hanover Nat'l Bank v. Moyses, 186 U.S. 181, 188, 22 S. Ct. 857, 46 L. Ed. 1113 (1902). Congress' first attempt at crafting a municipal bankruptcy statute in response to the Great Depression was struck down by the court. Id. Amendments to the statute made in 1937 were upheld as constitutional by the United States Supreme Court in United States v. Bekins, 304 U.S. 27, 58 S. Ct. 811, 82 L. Ed. 1137 (1938). In 1942, the Supreme Court also validated the state's right to compel creditors to accept a plan adjusting municipal debts even though such adjustment might be construed by objecting creditors as an impairment of their contractual rights. Faitoute Co. v. Asbury Park, 316 U.S. 502, 62 S. Ct. 1129, 86 L. Ed. 1629 (1942).

(2) HISTORICAL BACKGROUND

The Bankruptcy Code is found at Title 11 of the United State Code. It is divided into Chapters. Chapter 9 is the chapter devoted to the adjustment of debts of a municipality. Chapter 7 governs liquidations for individuals and corporations. Chapter 11 provides for business restructuring. Chapter 13 is a repayment plan for individual wage earners and Chapter 12 is for Family Farmers. The remaining chapters deal with case administration. Some of the provisions in these remaining chapters apply to municipalities while others do not.

b. ELIGIBILITY FOR FILING

(1) BANKRUPTCY CODE SECTION 109(c)

Bankruptcy Code section 109(c) contains the eligibility requirements for filing a bankruptcy case under Chapter 9. In summary these requirements are:

(a) the entity must be a municipality;
(b) state law must authorize the filing of a bankruptcy case;
(c) the entity must be insolvent;
(d) the entity desires to effect a plan to adjust its debts; and
(e) the entity has obtained agreement to its adjustment plan from creditors or good faith negotiations with creditors have been unsuccessful.

(2) DEFINITION OF MUNICIPALITY

A "municipality" is defined under section 101(40) of the Bankruptcy Code as a political subdivision or instrumentality of a state. The key issue in determining whether an entity will be classified as a municipality is whether there is direct state or municipal control over the entity. Cf. In re Ellicott School Building Authority, 150 B. R. 261 (Bkrtcy. D. Co. 1992) (non-profit corporation created to build a school and lease it to a school district held not to be a municipality) and In re Greene County Hospital, 59 B.R. 388 (Bkrtcy. S.D. Miss. 1986) (hospital under the control of the county board of supervisors qualified as a municipality).

(3) STATE AUTHORIZATION

Bankruptcy Code section 109(c)(2) reserves each state the power to determine the extent to which a municipality may avail itself of the protections of the Bankruptcy Code. In California the enabling authority for filing is contained in Government Code sections 56760 and 43739.

(4) INSOLVENCY

In cases involving entities other than municipalities, insolvency is evaluated primarily on a balance sheet test measuring the value of assets against liabilities. In municipal bankruptcy cases the evaluation is based on an analysis of existing and projected cash flow. The City of Bridgeport, Connecticut filed bankruptcy in 1991 as part of a strategy to reject certain burdensome labor agreements. At that time, the city projected a budget deficit of $16 million. The bankruptcy court, however, dismissed the petition, finding that the city's existing cash position and forecasted revenues from pre-existing taxes, failed to support the city's contention that it would be unable to pay its debts as they became due. In re City of Bridgeport, 132 B.R. 85 (Bkrtcy. D. Conn. 1991).

2. CASE ADMINISTRATORS

a. COMMENCEMENT OF THE CASE

(1) FILING PROCEDURES

A Chapter 9 case is commenced by the filing of a form bankruptcy petition in the county in which the municipality is located. (11 U.S.C. §§ 301 and 901(a). A filing fee of $300 must be paid at the time of filing. See 28 U.S.C. § 1930. Along with the petition, the municipality must file a "Statement of Qualifications" to establish the eligibility requirements contained in 11 U.S.C. section 109(c) discussed above and a list containing the names and addresses of its creditors. See 11 U.S.C. § 924. The municipality must also file a separate list identifying its 20 largest creditors.

(2) PUBLICATIONS

A Notice of Commencement of a Chapter 9 case must be published in a newspaper of general circulation in the district where the case is filed once a week for three successive weeks. See 11 U.S.C. § 923.

(3) JURISDICTION

The Bankruptcy Court has jurisdiction over bankruptcy cases pursuant to Title 28, United States Code section 1334(a) (the district courts shall have original and exclusive jurisdiction of all cases under Title 11), Title 28, United States Code section 157(a) (authorizing the district courts to refer all Title 11 cases and proceedings to the bankruptcy judges for the district) and General Order No. 266, dated October 9, 1984 (referring all Title 11 cases and proceedings to the bankruptcy judges for the Central District of California). Non-municipal cases are randomly assigned on a rotating basis to judges sitting in the division where the case is filed. In municipal cases, however, the Chief Judge of the Court of Appeals for the Circuit designates the judge to whom a Chapter 9 case will be assigned.

PRACTICE TIP: Although there is a form and order for designation of a bankruptcy judge, it is generally good practice to alert the Clerk of the Court and the Chief Judge of the Court of Appeals prior to actually filing the case so that the designation can be handled informally and without delay.

(4) ORDER FOR RELIEF

The filing of the bankruptcy petition itself is not an automatic adjudication of the eligibility of the municipality for bankruptcy relief. Pursuant to Title 11, United States Code section 921(c) creditors may object or move to dismiss the petition on the grounds that the municipality is not insolvent or that the petition was not filed in good faith. If no objection to the petition is filed, the Debtor entity needs to file a Motion for Order for Relief Under Chapter 9 and an Order for Relief.

(5) RETENTION OF STATE CONTROL OVER MUNICIPALITY

The filing of a Chapter 9 petition does not abrogate the power of a state to exercise control over a municipality through exercise of its political or governmental powers, including expenditure of revenues incidental to exercise of those powers. 11 U.S.C. § 903. In addition, Title 11, United States Code section 904 specifically prohibits the Bankruptcy Court from issuing any order that would interfere with the exercise of the municipality's governmental powers or disposition of its revenues. In the Chapter 9 filed by the County of Orange, for example, the Bankruptcy Court declined to order the County to pay counsel hired by various subcommittees representing special interest groups on the grounds that to do so would be an interference with the County's authority to control its expenditure of revenue. See In re County of Orange, 179 B.R. 195 (Bkrtcy. C.D. Cal. 1995).

b. AUTOMATIC STAY

(1) STATUTORY AUTHORITY

One of the main benefits for the debtor in filing a bankruptcy case is the automatic stay provided under Titlė 11, United States Code section 362. The stay acts as an injunction of any action against a debtor to collect pre-existing debts or to obtain property of the debtor to satisfy such debts. Title 11, United States Code section 362 applies to municipality filings under Chapter 9. In addition, Title 11, United States Code section 922 enlarges the scope of the automatic stay in municipal cases to cover proceedings against officers or inhabitants of the municipality seeking to enforce a claim against the municipality and to preclude any creditor from enforcing a lien on or arising out of taxes or special assessments owed to the municipality. See Mission Independent School Dist. v. Texas, 116 F.2d 175 (5th Cir. 1940); Touehton v. City of Fort Pierce, 109 F.2d 370 (5th Cir. 1940).

(2) EXCLUSION FOR PLEDGED SPECIAL REVENUES

"Special revenues" are defined under Bankruptcy Code section 902(2) and include receipts from transportation or utility services, special excise taxes; incremental receipts from tax benefit districts and project financing taxes. Bankruptcy Code section (d) provides that the automatic stay does not extend to the application of pledged special revenues to payment of indebtedness secured by those revenues. As a corollary, Bankruptcy Code section 928 extends any pre-petition consensual lien against Special Revenues to funds received post-petition and precludes diversion of such funds for general municipal purposes. This is in contrast to the general rule under Bankruptcy Code section 552(a) that a pre-petition security interest does not extend to property acquired post-petition. See In re County of Orange, 179 B.R. 195 (Bkrtcy. C.D. Cal. 1995), remanded 189 B.R. 499.

c. PLAN CONFIRMATION

(1) OVERVIEW

The primary purpose of the chapters in the Bankruptcy Code governing reorganization is to provide a debtor with a respite from creditor pressure in order to allow the filing and confirmation of a repayment plan. In the context of a Chapter 9 case, whether a plan gets confirmed generally hinges on the extent to which the municipality will be required to exercise its taxing authority to generate a repayment that will be fair and equitable to creditors. See, e.g., Fano v. Newport heights Irrigation Dist. 114 F.2d 563 (9th Cir. 1940).

(2) WHO MAY FILE A PLAN

In Chapter 9, unlike in Chapter 11, only the debtor municipality has the right to propose a plan. 11 U.S.C. § 941. This rule is necessary to preserve the municipalities duty to retain control over its political affairs as required by the Tenth Amendment to the United States Constitution and as codified in Bankruptcy Code sections 903 and 904. While a creditor may not propose any reorganization plan, it may petition the court to set a deadline for the municipality to file a plan after which time the case would be dismissed if no plan had been filed.

(3) CONTENTS OF PLAN

Chapter 9 selectively incorporates many of the provisions contained in the Chapter 11 business reorganization section including most of the provisions set forth in Bankruptcy Code section 1123 governing the contents of a reorganization plan. It is mandatory that the plan designate classes of creditors, 11 U.S.C. § 1123(a)(1); that the plan specify what classes of creditors are unimpaired by the plan, 11 U.S.C. § 1123(a)(2); that the plan specify the treatment of each class of impaired creditors, (11 U.S.C. § 1123(a)(3); that the plan provide for uniform treatment of creditors within each class, (11 U.S.C. § 1123(a)(4); and that the plan set forth a means for implementation of the plan provisions. 11 U.S.C. § 1123(a)(5). A claim is considered "impaired" when the legal, equitable or contractual rights of a claimant have been altered in any fashion either through diminution or enhancement. 11 U.S.C. §1124; In re L & J Anaheim Associates, 995 F.2d 940 (9th Cir. 1993). Bankruptcy Code section 1123(b) which sets forth the permissive contents of a plan is also incorporated into Chapter 9.

(4) CONFIRMATION REQUIREMENTS

Bankruptcy Code section 901 selectively incorporates some of the provisions of Title 11, United States Code section 1129 which govern the requirements for confirmation in the context of a business reorganization. In addition, Bankruptcy Code section 943 contains additional confirmation requirements applicable only to municipalities. Among the most important plan confirmation requirements are feasibility, 11 U.S.C. § 943(7); In re City of Colorado Springs Spring Creek General Improvement District, 177 B.R. 684 (Bkrtcy. D. Colo. 1995), and that the debtor is not prohibited by law from taking any action necessary to carry out the plan. 11 U.S.C. § 943(4); Sanitary & Improvement District 65 v. First National Bank, 79 B.R. 877 (D. Neb. 1987), aff'd per curiam 873 F.2d 209 (8th Cir. 1989).

3. SPECIAL ISSUES

a. LABOR CONTRACTS

(1) BACKGROUND

Bankruptcy Code section 365 permits debtors to reject executory contracts based on a business judgment analysis. In the seminal case of NLRB v. Bildisco & Bildisco, 465 U.S. 513, 79 L. Ed. 2d 482, 104 S. Ct 1188 (1983), the Supreme Court held that section 365 was applicable to collective bargaining agreements and that a debtor did not have to comply with the contract terms or federal labor laws before rejecting the contract. In 1994, section 1113 of the Bankruptcy Code was enacted which requires corporate debtors to enter into good faith negotiations with the union prior to rejection of any labor agreement.

(2) LABOR CONTRACTS IN CHAPTER 9

Significantly, section 1113 was not incorporated into Chapter 9. During the County of Orange bankruptcy case, the County attempted to abrogate its Memorandums of Understanding with various county employee collective bargaining units by terminating personnel based on necessity without regard to seniority. Relying on the case of Sonoma County Organization of Public Employees v. County of Sonoma, 23 Cal. 3d 296, 591 P.2d 1, 5, 152 Cal. Rptr. 903 (1979) ("Sonoma I"), the Bankruptcy Court ruled in In re County of Orange 179 B.R. 195 (Bkrtcy. C.D. Cal. 1995), that although the requirements of Title 11, United States Code section 1113 did not apply to Chapter 9, the county was required to negotiate with its employee collective bargaining units prior to modifying its labor agreements and that its ability to modify them was restricted to those emergency circumstances described in Sonoma I, that (a) a declared emergency must be based on an adequate factual foundation; (b) the agency's action must be designed to protect a basic social interest and not benefit a particular individual; (c) the law must be appropriate for the emergency and obligation; and (d) the agency decision must be temporary, limited to the immediate exigency that caused the action. Sonoma I, 591 P.2d at 5.

STANDARD & POOR'S PUBLIC FINANCE
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Commentary

Revised Lease and Appropriation-Backed Debt Rating Criteria

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Criteria Changes
Rating Considerations

The data gathered in the preparation of Standard & Poor's "Municipal Rating Transitions and Defaults" study indicates that lease and appropriation debt rated by and meeting legal requirements tracks precisely with the obligor's long term rating. As a result, the ratings on these obligations will now be more a reflection of the obligor's general credit and focus on project detail will be reduced. The traditional multiple notching off the general obligation rating will be eliminated and lease and appropriation obligations that meet our legal criteria will be rated one notch off the general obligation ratings, effectively eliminating the historic reliance on essentiality as a credit factor. Although reduced in magnitude, notching will continue, as a reflection that leases and appropriation obligations are not legally debt and do not bear the same legal protections as general obligation bonds.

This change applies only to capital obligations, not operating or vendor obligations.

This decision reflects:

- The maturation of the appropriation-backed market;
- The comparable low risk of default between general obligation bonds and appropriation-backed debt;
- The long history of appropriation-backed financing by state and local governments; and
- The significant incorporation of contractual debt within the capital plans for state and local governments.

Last year, Standard & Poor's raised the ratings on nine states' contractual dependent ratings to one notch below the obligor's GO rating for similar reasons. That decision laid the groundwork for today's action.

Standard & Poor's has been rating appropriation-backed debt for more than two decades. Over that time, we have seen a greater acceptance of this form of debt within the public markets. Once confined to a limited number of municipal governments in California, this type of debt issuance is now common in at least 33 states. Over the last 20 years, the occurrence of a default on appropriation-backed debt has been similar to the default rate of general obligation bonds. The default risk is low for both types of debt issuance and the significant difference in credit risk identified by a rating differentiation of one full category no longer accurately reflects the minimal difference in default risk. Standard & Poor's has also seen appropriation-backed contracts become a critical component of both state and local governments' capital infrastructure programs, in some instances making up over 50% of the capital program. Furthermore, state and local government managements understand the capital markets and obligations under these programs. Finally, while appropriation-backed bonds are not considered debt under a strict legal definition, Standard & Poor's considers all appropriation-backed bonds of an issuer to be an obligation of that issuer and a failure to appropriate will result in a significant credit deterioration for all types of debt issued by the defaulting government.

Criteria Changes

Standard & Poor's criteria for evaluating the legal structure, cited below, will remain the same. However, there are three areas of Standard & Poor's criteria that, as a result of this decision, will change.

Essentiality. Evaluation of the essentiality of a particular project and the willingness to pay for that project is a part of the analysis performed in the assessment of the general creditworthiness of the issuing government and will not be the basis for a distinction in the assignment of a contractual debt rating. The decision as to what type of debt to issue to fund a government's capital plan is secondary to the types of projects that government has chosen to enter into. As such, the evaluation of a government's capital program incorporates both the need for a particular project as well as the government's ability to provide for the payment of any debt associated with that debt issuance. If a state or local government enters into a proportionately large amount of projects that are controversial or are designed to promote economic development while ignoring the basic service delivery needs of that government, that decision will be reflected in the general creditworthiness of the issuer and not only in the assessment of a rating for a particular debt issue

Security interest. The second area of change is in the provision of a security interest in the financed project. Security interest is a common lease feature, in which the governmental lessee grants the lessor--or the trustee, as assignee of the lessor--title or a first lien on the leased property for the life of the bonds. In the event the lessee chooses to exercise its right of nonappropriation, the lessor, or its assignee, has the right to take possession of the leased asset. For many projects, even if a security interest is granted, it is questionable as to whether the lessor or its assignee can effectively take possession of the projects, as in the case of a prison, a government center, a school or any other facility which serves the basic functions of that government. Therefore, a security interest in those projects, which Standard & Poor's considers to be used for a basic government function, will no longer be required. However, for those projects that do not meet this definition, Standard & Poor's will evaluate the transaction within the context of that state's laws and the government's specific circumstances, but this feature should be included if it is available.

General creditworthiness. Finally, since all appropriation-backed debt will now be rated one notch below the obligor's general creditworthiness, the evaluation will shift from a particular project financing to the overall assessment of the general creditworthiness of the government itself.

Rating Considerations

To rate a lease transaction requiring annual appropriations, Standard & Poor's evaluates the following:

Lessee general creditworthiness. The government obligor's general creditworthiness evaluation is based on traditional general obligation analysis and includes factors such as:

- Overall debt structure and burden,
- Economic and tax-base factors,
- Financial flexibility, performance, and position, and
- Administrative and management factors.

If the government obligor were a utility district, university, hospital, or other not-for-profit entity, the relevant rating criteria used in assessing credit quality for those types of entities would be applied. Please refer to Standard & Poor's Public Finance Criteria for more detail.

Security features. The history of legislative authorizations for lease financings, prior leasing experience, and the intent of the lessee—indicated, for example, by an equity interest in the leased property—are important in determining lease ratings. However, these factors are not substitutes for adequate legal protections. In some states, because of constitutional or statutory limitations, lease-secured debt is the only practical financing option.

Appropriation and term features. For leases where the commencement of rentals depends on successful completion or acceptance of the property being financed, the rating is "provisional." For a master lease, when the lessee uses one lease agreement for multiple leased properties, Standard & Poor's requests that the acceptance and effective date of lease payments be tied to the receipt of the major lease component.

For state-level master leases, where numerous operating departments may be involved, a centralized appropriations process helps to ensure the timely payment of obligations.

The following appropriation features are important to the evaluation of the transaction's structure:

- The useful life of the leased property or project matches or exceeds the term of the lease contract.
- The term of the lease contract matches the term of the bond issue or certificates of participation, avoiding exposure on renegotiation; if state law prohibits long-term leases, term renewal should be automatic.
- The lease payments represent installments toward an equity buildup in the leased property. At the end of the lease and debt terms, ownership of the asset should transfer to the lessee automatically or for a nominal fee.
- The lessee agrees to request appropriations for lease payments in its annual budget.
- The lessee unconditionally agrees to make rental or purchase option payments as agreed. Such payments should not be subject to counterclaim or offset as a result of a disagreement over any aspect of the transaction. A clear statement that "notwithstanding any other provisions to the contrary, lease rental payments are triple-net not subject to counterclaim or offset" should be included in the lease contract.

For California lessees, the lessee covenants to appropriate lease payments, subject to abatement in the event the leased property is not available for use.

Although Standard & Poor's also rates annual appropriation-style leases for California issuers, abatement leases are viewed favorably for their accruing characteristics.

Central approval and oversight. In some states, there is strong oversight by the state of local entities' debt issuance and budgeting practices, which extends to lease contracts. This oversight is considered a positive in the overall evaluation of the general creditworthiness of the government.

Underlying revenues in support of appropriation-backed securities. In certain circumstances, a government may legally pledge specific tax revenues to meet its lease payment obligation. If the pledged revenues are not available for any purpose other than those consistent with the appropriation project, such as economic development or a convention center, the appropriation risk is significantly mitigated.

Maintenance and insurance. The lessee should agree to maintain the leased property in good repair and to insure it against loss or damage in an amount at least equal to the purchase option value or replacement cost, if repair and replacement are mandated by the lease agreement. If lease payments are subject to abatement in the event the property is damaged, destroyed, or taken under a provision of eminent domain, the lessee must maintain business interruption insurance. Where applicable, special hazard insurance coverage is required unless the leased facility passes Standard & Poor's natural hazard test.

Self-insurance for property damage risks is permitted. Adequate reserve levels must be maintained and reviewed annually by an independent consultant or professional risk manager. Annual notification to the trustee that reserve levels are adequate must be made. Self insurance is not an acceptable alternative to commercial coverage for earthquake risk when the lessee's obligation is limited only to self-insurance reserves and does not extend to the municipality's general resources.

Debt service reserve fund. A debt service reserve equal to maximum semiannual debt service or six months advanced (and unconditional) funding of debt service, or an equivalent combination of reserves and advance funding, may be required. This applies to leases that provide for abatement for lost use of property owing to damage or destruction or to leases where late budget passage risk exists.

Lessor features and bankruptcy risk. Most lease transactions rated by Standard & Poor's are between a governmental lessee and a non-profit public benefit corporation, as lessor, which has been established specifically for the purposes of the lease transaction. These lessors, typically, are filers under Chapter 9 of the U.S. Bankruptcy Code and are considered to be bankruptcy remote.

For lessors not judged to be bankruptcy remote, there must be a sale and absolute assignment by the lessor of lease rental payments to the trustee, thereby ensuring timely payment to the bondholders if the lessor becomes insolvent. The assignment should be accompanied by a legal opinion stating that as a result of the assignment, bankruptcy of the lessor would not cause the lease and lease payments to be considered property of the lessor's estate.

The automatic stay provisions of the Bankruptcy Code should not apply and therefore would not cause an interruption of rental payments to the bond trustee.

Insolvency-proofing the lessor is an alternative approach. The lessor should be set up as a single-purpose entity (SPE) that is prohibited from engaging in any business—other than owning the rated project—and from incurring additional debt, unless it is rated at least as high as the Standard & Poor's rated lease-secured debt. Furthermore, the SPE may not sell the project except to another entity that meets these criteria unless the entity's senior debt is rated by Standard & Poor's at least as high as the lease obligation. These provisions should appear in the lessor's partnership agreement or articles of incorporation and in the trust indenture. Please refer to Standard & Poor's criteria on SPEs for more detail.

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MODEL BOND OPINION REPORT

National Association of Bond Lawyers
Committee on Opinions and Documents

This report, prepared by the Committee on Opinions and Documents (the "Committee") of the National Association of Bond Lawyers ("NABL"), is the fourth edition of NABL's model bond opinion reports, each of which was designed to reflect then-current municipal bond practice. The report and the model opinions included in it are updates of earlier model opinions included in the Model Opinion Project prepared in 1982 and 1983 by the committee chaired by M. Paul Martin and subsequently revised in 1987 and 1997 by committees chaired by the late Thomas S. Currier and Michael A. Budin, respectively. The current report reflects general developments in opinion practice and the municipal bond industry since the 1997 report, including increasing complexity in federal tax law. Future revisions may be needed over time to reflect further changes. The Board of Directors of NABL has authorized the distribution of this report.

In its consideration of current developments and practice in the municipal bond industry, the Committee recognized the importance of the bond opinion to bond purchasers, and what it means—and does not mean. In response, while reaffirming the high degree of confidence bond counsel should have before rendering an "unqualified" opinion, the report more clearly articulates the examination process involved in reaching the conclusions necessary for an "unqualified" opinion (*i.e.*, an opinion subject only to customary assumptions, limitations, and qualifications, and not "explained"). The report states that bond counsel "may render an 'unqualified' opinion regarding the validity and tax-exemption of bonds if it is firmly convinced (also characterized as having a 'high degree of confidence') that, under the law in effect on the date of the opinion, the highest court of the relevant jurisdiction, acting reasonably and properly briefed on the issues, would reach the legal conclusions stated in the opinion." The Committee believes that this articulation more accurately reflects current practice, conforms the basis for such opinions to the recognized basis for "unqualified" opinions in other types of business transactions, and results in a more consistent and rational basis on which practitioners can determine whether a bond issue can be the subject of an "unqualified" opinion. This articulation also comports with the high standard of care historically applied by leading practitioners throughout the country. It is not intended to reduce either the level of certainty that bond counsel, in its professional judgment, should reach before delivering an "unqualified" opinion or the level of confidence to be afforded such opinions by bond purchasers.

The disclosure section of the report has been expanded to provide guidance to participants in public finance transactions with respect to opinion and tax related disclosure items, including the disclosure of post-issuance federal tax law requirements. While taking no position on the use of "exploding," "reasoned" or "qualified" opinions in municipal bond transactions, the report does note that when used, such opinions should be accompanied by appropriate disclosure to reflect the lower level of certainty inherent in the legal conclusions expressed in "reasoned" or "qualified" opinions and the circumstances in which an "exploding" opinion may cease to apply.

As with prior updates, in addition to significant other research, the Committee has given substantial attention to the forms of opinions used in non-municipal finance transactions, and to numerous articles and publications on opinions by individuals and bar groups. Useful references include *Glazer and Fitzgibbon on Legal Opinions, Second Edition,* Aspen Law & Business (2001), which includes an extensive annotated bibliography and copies of reports of various state bar groups; *Drafting Legal Opinion Letters, Second*

Edition, John M. Sterba, Wiley Law Publications (1992, as supplemented); and *Guidelines for the Preparation of Closing Opinions* (the "*Guidelines*"), prepared by the Committee on Legal Opinions of the ABA Section of Business Law, printed in *The Business Lawyer*, Vol. 57 (February 2002), including *Legal Opinion Principles* (the "*Principles*") appended as *Appendix A* thereto. The Committee cautions, however, that care should be taken in using such references, as substantial differences between general commercial transactions and municipal financings can require substantially different opinions. Some of these differences are discussed in the commentary accompanying this report.

Reference also should be made to *The Function and Professional Responsibilities of Bond Counsel, 1995 Second Edition* ("*Function*"), published by NABL, which provides guidance and insights regarding the responsibilities of bond counsel in rendering opinions. The discussion of the appropriate basis for delivering an "unqualified" opinion articulated in *Function* is superseded by the discussion in this report. Although some of the commentary accompanying this report refers to specific sections in *Function*, counsel rendering bond opinions should read *Function* in its entirety. Further, bond counsel should refer to *Model Engagement Letters*, published by NABL (1998) ("*Engagement Letters*"), which addresses in greater detail considerations relating to engagement letters and ethical issues encountered in rendering bond opinions. Bond counsel should also refer to *Statement Concerning Standard Applied in Rendering the Federal Income Tax Portion of Bond Opinions*, adopted by the NABL Board on November 29, 1993 ("*Tax Standard*"). As with *Function*, *Tax Standard* includes a discussion of the "unqualified" opinion that is superseded by this report.

This report was developed by the Committee, comprising the following members:

J. Foster Clark, Chair
Frederic L. Ballard, Jr.
Michael A. Budin
Richard Chirls
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Linda L. D'Onofrio, Vice Chair
Julianna Ebert
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Floyd C. Newton, III
Robert Dean Pope
Fredric A. Weber

Significant portions of this report were developed under the leadership of Kristin H. R. Franceschi while she chaired the Committee. The Committee received considerable support from members of the Board of Directors of NABL, including, in particular, W. Jackson Williams, who acted as a liaison to the Board and provided valuable guidance and constructive comments throughout the preparation of this report.

As with prior model opinion reports, the model opinions and commentaries included in this report are intended to assist bond counsel and not to create a mandatory standard for the subjects of the opinion, its wording, or the basis for rendering it. Opinions delivered in practice will vary from the model opinions as a result of factual differences, different bond counsel presentation styles, and local practices. Coverage of any matter in the model opinions is not intended to suggest that bond counsel has a duty to address that matter in an opinion. Conversely, the failure to cover any matter in the model opinions does not suggest that including such matter in an opinion is improper.

The model opinions and accompanying commentary included in this report represent the views of the Committee. Differing views are described in the commentary. The Committee welcomes comments so that future revisions may reflect appropriate considerations and correct any deficiencies.

J. Foster Clark
Chair
Committee on Opinions and Documents

February 14, 2003

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INTRODUCTION

This report is intended to assist bond counsel in preparing opinions for three basic categories of bonds: (1) general obligation bonds to which the full faith and credit of the issuer is pledged and that do not constitute private activity bonds within the meaning of the Internal Revenue Code of 1986 (the "Code"), (2) revenue bonds secured by specified revenues of the issuer and that do not constitute private activity bonds, and (3) certain private activity bonds that are conduit financing bonds. Although the model opinions have been drafted for these three basic categories of bonds, many other types of bonds exist, *e.g.*, certain general obligation bonds and revenue bonds that are private activity bonds but not conduit financing bonds. Additional considerations and opinions may be appropriate for these other types of bonds. While such variations and nuances are beyond the scope of this report, some explanatory cross references have been added to assist bond counsel in drafting an opinion that is a hybrid of the three designated forms.

This report presumes that bond counsel either is or will become knowledgeable of the relevant considerations in rendering the bond opinion in a particular transaction. In this regard, in addition to the references cited in the cover letter for this report (namely *Glazer and Fitzgibbon on Legal Opinions, Drafting Legal Opinion Letters, Guidelines, Principles, Function*, and *Tax Standard*), bond counsel should refer to *Disclosure Roles of Counsel in State and Local Government Securities Offerings, Second Edition (1994) ("Disclosure Roles")*, from a project sponsored by NABL and the American Bar Association, and *Engagement Letters*. These sources provide guidance on substantive issues to be considered in rendering opinions, relevant disclosure issues, and ethical issues that bond counsel should consider.

The model opinions assume that bond counsel is engaged to render the typical bond opinion for the particular category of bond. A different engagement could require opinions in addition to, or fewer opinions than, those included in the relevant model opinion. For example, in a private activity bond transaction in which bond proceeds are loaned to a third-party conduit borrower, bond counsel might be engaged to opine on the binding and enforceable nature of agreements against the conduit borrower as well as against the issuer. Similarly, if two firms are engaged to render different portions of the bond opinion (as, for example, where special tax counsel is engaged to render the tax portion of the opinion), each firm's opinion might address fewer areas than those indicated in the model opinion, although the combined opinions would normally cover all items in the model opinion. This division would also occur where the initial bond purchaser receives an opinion of the issuer's general counsel regarding all matters other than tax exemption, and bond counsel is engaged solely to render the tax-exemption opinion. *See Disclosure Roles*, at pages 65 through 69, for a discussion of bond counsel's ability to limit its opinion responsibility through a division of assignments among, or reliance on, competent counsel. *See also* the discussion of "Model Rule 1.2—Scope of Representation" in *Function*, which suggests that an engagement letter might be used to record bond counsel's consultation with the issuer concerning the customary functions that are being omitted from the scope of representation and the issuer's consent to this limitation.

The comments following each model opinion are intended to explain certain language in the opinion, to provide background, to identify areas where different views exist, or to highlight issues that should be considered. The comments following the model opinion for general obligation bonds apply as well to corresponding language in the model opinions for revenue bonds and private activity bonds. Similarly, the comments following the model opinion for revenue bonds apply to corresponding language in the model opinion for private activity bonds. Although some comments apply to similar opinions in other municipal finance transactions, this report, the model opinions, and the commentary are intended to address only bond opinions.

As with prior reports, this report includes a section discussing ccrtain issues to be considered for inclusion in a disclosure document prepared and distributed by the issuer or those authorized to do so on its behalf. Although bond counsel's role does not always include preparing or reviewing the disclosure document, this report includes thoughts regarding the relationship between disclosure and the bond opinion. Cross references to relevant portions of the disclosure matters section appear in the comments.

This report includes a bibliography of the books, handbooks, articles, and cases cited.

I. GENERAL OBLIGATION BONDS (A)

MODEL OPINION

[*Note*: Letters in parentheses refer to the Commentary immediately following this opinion.]

(Letterhead of Bond Counsel)
(Date) **(B)**

(Addressee) **(C)**

(Salutation) **(D)**

(Caption)

We have acted as bond counsel to ____________(E) in connection with the issuance by (*Name of Issuer*) (the "Issuer") of $______________ (*Title of Bonds*) Bonds dated ______________ (the "Bonds"). **(F)** In such capacity, we have examined such law and such certified proceedings, certifications, and other documents as we have deemed necessary to render this opinion. **(G)**

Regarding questions of fact material to our opinion, we have relied on the certified proceedings and other certifications of public officials and others furnished to us without undertaking to verify the same by independent investigation.

Based on the foregoing, we are of the opinion **(H)** that, under existing law:

1. The Bonds have been duly authorized and executed by the Issuer, and are valid and binding general obligations of the Issuer. **(I)**

2. All taxable property in the territory of the Issuer is subject to *ad valorem* taxation without limitation regarding rate or amount to pay the Bonds. **(J)** The Issuer is required by law to include in its annual tax levy the principal and interest coming due on the Bonds to the extent that necessary funds are not provided from other sources. **(K)**

3. Interest on the Bonds is excludable **(L)** from gross income for federal income tax purposes and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations; however, such interest is taken into account in determining adjusted current earnings for the purpose of computing the alternative minimum tax imposed on certain corporations. The opinion set forth in the preceding sentence is subject to the condition that the Issuer comply with all requirements of the Internal Revenue Code of 1986, as amended, **(M)** that must be satisfied subsequent to the issuance of the Bonds in order that the interest thereon be, and continue to be, excludable from gross income for federal income tax purposes. **(N)** The Issuer has covenanted to comply with all such requirements. **(O)** Failure to comply with certain of such requirements may cause interest on the Bonds to be included in gross income for federal income tax purposes retroactively to the date of issuance of the Bonds. **(P)**

4. [Opinion regarding state tax exemption, if any.] **(Q)**

The rights of the owners of the Bonds and the enforceability of the Bonds are limited by bankruptcy, insolvency, reorganization, moratorium, and other similar laws affecting creditors' rights generally, and by equitable principles, whether considered at law or in equity. **(R)**

We express no opinion [herein] regarding the accuracy, adequacy, or completeness of the [disclosure document] relating to the Bonds. **(S)** Further, we express no opinion regarding tax consequences arising with respect to the Bonds other than as expressly set forth herein.

[This opinion is given as of the date hereof, and we assume no obligation to revise or supplement this opinion to reflect any facts or circumstances that may hereafter come to our attention, or any changes in law that may hereafter occur.] **(B)**

Very truly yours,

COMMENTARY

(A) General Obligation Bonds

This form of opinion applies only to general obligation bonds that are not private activity bonds. Bond counsel preparing an opinion for general obligation bonds that are private activity bonds, but not conduit financing bonds, may begin with this form, modifying paragraph 3 (relating to the excludability of interest on the bonds) as indicated in Part III.

(B) Date of Opinion; Lack of Obligation To Update

The opinion is ordinarily dated as of the date of original issuance, which is the date of original delivery of and payment for the bonds. The opinion speaks only as of its date, and reflects the law and facts on such date. Unless expressly engaged to do so, bond counsel does not undertake to inform any person regarding any subsequent development that may affect the opinion. Although this concept always has been implicit in bond opinions, bond counsel may wish to state it explicitly, as is done in the final, optional paragraph of this opinion, particularly in light of the increasing complexity of the post-issuance compliance required of issuers (and conduit borrowers) to maintain the tax-exemption of interest on the bonds. *See* Comment (N), and *Disclosure Roles*—Date of Bond Opinion, at pages 150 and 151, for further discussion of this issue, including concerns arising from continued reliance on the bond opinion in the secondary market, and concerns regarding republication. See also "Disclosure Matters - Disclosure Issues - Tax Issues - Exploding Opinions" for a discussion of "exploding" opinions and suggested disclosure with respect to such opinions.

(C) Addressees

Practice varies regarding the addressees of the opinion. Frequently, the opinion is addressed to the issuer, the underwriters (or other original purchasers), or both. Occasionally, the opinion is addressed to an appropriate officer of the issuer or to another party (such as the paying agent). Sometimes the opinion is not addressed to anyone.

Unless otherwise stated, subsequent owners of the bonds are also intended to rely on the opinion distributed with or printed on the bond. *See Bradford Securities Processing Services, Inc. v. Plaza Bank and Trust*, 653 P.2d 188 (Okla. 1982). The opinion, however, speaks only as of its date. *See* Comment **(B)**.

Without regard to the state of the law concerning who may bring an action against an attorney for a negligently given opinion, bond counsel should recognize that a bond opinion, by its very nature, is intended to be relied on by non-clients, such as underwriters, bondholders, and any trustee for the bondholders. *See Function*—Model Rule 2.3— Evaluation for Use by a Third Person, concerning whether bond counsel owes a duty to a third-party recipient (*e.g.*, the underwriter), even though that third-party recipient is clearly not the client, as a result of being hired to disclose information that is normally confidential. Frequently, a bond purchase contract evidences that bond counsel's client has directed bond counsel to deliver its opinion to specified parties. To avoid any assertion that they may not rely on bond counsel's opinion, underwriters and trustees typically require that they be addressees or be given separate reliance letters. An addressee underwriting syndicate is sometimes described by referring to the designated managing underwriters in their capacity as representatives for the underwriters. *See Function*—The Bond Opinion—Limited Nature of Bond Opinion, for a discussion of jurisprudence addressing the basis of liability of counsel to non-clients, and *Function*—Professional Responsibilities of Bond Counsel—Significance of Client

Relationship, which suggests that bond counsel should carefully consider and explain to its client the basis for and the implication of duties that may be owed to non-clients.

(D) Salutation

A salutation is unnecessary. Salutations, where used, vary from firm to firm or by local practice. If a salutation is to be used, however, a gender-neutral salutation such as "Ladies and Gentlemen" or "To the Addressees" should be used.

(E) Who Engaged Bond Counsel

Because bond counsel is advised to have an identifiable client in a bond transaction (rather than, for example, purporting to represent the transaction, or the owners of the bonds), bond counsel should identify its client in the bond opinion to dispel any belief by others that bond counsel represented them in the transaction. Some bond counsel also identify their client to other participants in the transaction by means of a memorandum of client relationship. *See Function*—Disclosure Matters—Potential Conflicts of Interest, and *Engagement Letters*.

In the case of general obligation bonds and non-conduit revenue bonds, the issuer usually engages bond counsel. The engagement of bond counsel by a different party, however, may result from factors such as local custom, the nature of the financing, which parties are represented by counsel, or the history or specifics of a given transaction. In the case of conduit financing bonds, practice varies from state to state and issuer to issuer, and bond counsel may be engaged typically by any of the three principal parties: (1) the issuer, (2) the conduit borrower or user, or (3) the underwriter, placement agent, or bond purchaser. In any case, the applicable basis for rendering the opinion is the same, and the fact of engagement by one party or another does not alter the requisite level of confidence for rendering the opinion.

(F) Description of Bond Issue and Transaction

A detailed description of the bonds need not be included in the opinion. The opinion is generally printed on or attached to certificated bonds ("good delivery" under Municipal Securities Rulemaking Board Rules G-12 and G-15 requires this). It is redundant to include in the opinion the maturities, interest rates, registration privileges, or terms of redemption, all of which are ordinarily set forth in any disclosure document accompanying the bonds.

Similarly, a detailed description of the transaction related to the bond issue need not appear in the bond opinion. The bond opinion is not a disclosure document, although it may be viewed as making statements in connection with the purchase and sale of securities and therefore should not mislead or misinform readers regarding the issues addressed. *See Disclosure Roles*—Description of Transaction, at page 151, and *Disclosure Roles*—Security Provisions, at pages 153 and 154, for a discussion of certain issues that bond counsel should consider in this regard, including avoidance of unintended inferences by recipients of the bond opinion (such as inferences that bond counsel has verified factual matters or makes any representation regarding the adequacy of the security or the ability of the issuer to pay).

(G) Scope of Examination

Instead of listing specifically the materials that bond counsel has examined, it is preferable to state that bond counsel has made a sufficient examination. The reference to "law" includes all sources of law, whether constitutions, statutes, regulations, rulings, court decisions, or other authoritative sources.

No specific reference is made to the examination of an executed bond, although historically examination of a bond was a common practice. Depending on the arrangements for delivery of bonds to the initial purchaser or purchasers, the delivery of an executed bond to bond counsel for examination and return may involve inconvenience and expense, and may create a security risk. Bond counsel should consider applicable local law, and exercise discretion regarding the appropriate procedure in each particular case, whether examination of an executed bond, a reproduced bond, a specimen bond, or a bond proof, or reliance on proofreading by another party.

As used in the model opinion, the term "certified proceedings" refers to the authorizing or other proceedings essential to the validity of the bonds. The term does not imply that validation or other judicial proceedings have occurred If, however, such proceedings have been held, it may be appropriate to state that fact in the opinion.

Bond counsel generally does not rely on opinions of other counsel in rendering the opinions in paragraphs 1 and 2 of the model opinion. Exceptions to this general practice usually involve special situations. If opinions of other counsel are relied on, the bond opinion should state that fact explicitly unless, in rendering its opinion, bond counsel is rendering a concurring opinion. *See* Comment **(DD)** for additional discussion regarding reliance on opinions of other counsel.

(H) "Unqualified" Opinion

In this report, the word "unqualified" describes an opinion that is subject only to customary assumptions, limitations, and qualifications, and that is not otherwise "explained." Using this definition, the model opinions are "unqualified" opinions. Consistent with this terminology, a bond opinion is not "unqualified" if it includes (1) a non-customary assumption, limitation, or qualification, (2) a phrase such as "while the matter is not free from doubt" (generally referred to as a "qualified" opinion), or (3) a legal analysis for the opinion (generally referred to as a "reasoned" or "explained" opinion). See "Other Types of Opinions" herein for a discussion of "qualified" and "reasoned" opinions. Customary assumptions, limitations, and qualifications are essential to the conclusions reached in the opinion and, thus, should be considered by the recipients of the opinion and by others who rely upon it. *See, e.g.*, the discussion in Comment (N) regarding post-issuance compliance.

Bond counsel may render an "unqualified" opinion regarding the validity and tax exemption of bonds if it is firmly convinced (also characterized as having "a high degree of confidence") that, under the law in effect on the date of the opinion, the highest court of the relevant jurisdiction, acting reasonably and properly briefed on the issues, would reach the legal conclusions stated in the opinion. *See Glazer and Fitzgibbon on Legal Opinions*, at 71-74. For issues of state law, the relevant court is the highest court of that state; for issues of federal law (*e.g.*, matters relating to the federal income tax treatment of interest on the bonds), such court is the U.S. Supreme Court. The recitation that the court has been "properly briefed" presupposes that it has been duly briefed on the material facts and all relevant law.

In the area of federal income tax matters addressed in the opinion, certain special circumstances are recognized. Too little authoritative judicial precedent has been established in many instances to enable bond counsel to evaluate its conclusions against the potential conclusions of a court. This lack of judicial precedent is due in part to the difficulties of placing issues before the courts in the tax-exempt bond area where the bondholder (rather than the issuer) is treated as the taxpayer entitled to challenge an adverse decision of the Internal Revenue Service. In addition, a significant and somewhat unique body of Internal Revenue Service administrative guidance exists, some of which is precedential and some of which is not formally precedential but which may nonetheless offer insight into the proper interpretation of federal income tax questions in appropriate cases. In recognition of these circumstances, bond counsel may nonetheless give an unqualified opinion with respect to federal income tax matters if it is firmly convinced that, upon due consideration of the material facts and all of the relevant sources of applicable law on federal income tax matters described below, the Supreme Court would reach the federal income tax conclusions stated in the opinion or the IRS would concur or acquiesce in the federal income tax conclusions stated in the opinion. In reaching this conclusion, bond counsel may consider authoritative and precedential sources for interpretation of relevant applicable law, including, without limitation the following: provisions of the Internal Revenue Code and other statutory provisions; Congressional intent as expressed in committee reports, joint explanatory statements of managers included in Congressional conference committee reports, and Congressional floor statements made prior to enactment by one of a bill's managers; temporary and final Treasury regulations construing the Internal Revenue Code and other relevant statutes; and IRS and Treasury administrative pronouncements which may be relied on formally as precedent, including, without limitation, revenue rulings, revenue procedures, notices, and defined "written determinations" under Treas. Reg. Sec. 1.6662-4(d)(3)(iv)(A) that address the specific tax issue for the specific matter involved in bond counsel's opinion (*e.g.*, a private letter ruling on the particular bond issue). In addition, bond counsel also may give appropriate consideration to non-precedential IRS administrative guidance, including, without limitation, proposed Treasury regulations (when temporary or final regulations have not yet been adopted), IRS private letter rulings, IRS technical advice memoranda, IRS general counsel memoranda, IRS Actions on Decision, and other IRS administrative announcements published in the IRS Cumulative Bulletin.

In rendering an "unqualified" opinion based on the requisite degree of confidence in its conclusions on federal tax matters, bond counsel should consider all the facts and circumstances regarding the particular sources of authority for relevant applicable law relied upon, including, without limitation, the weight, relevance, persuasiveness, age, frequency, and nature of the particular authority. Bond counsel may reach the requisite degree of confidence in its conclusion on a particular federal tax issue despite the absence of certain types of authority. Thus, it is possible, depending on all the facts and circumstances, for bond counsel to reach such a conclusion supported only by a well-reasoned construction of the applicable provision of the Internal Revenue Code and relevant legislative history.

Bond counsel, however, should not base an "unqualified" opinion on federal tax matters on non-precedential IRS administrative guidance that is inconsistent with authoritative and precedential guidance. Nor should bond counsel base an "unqualified" opinion with respect to federal tax matters on a belief that the applicable bonds will not be subject to an IRS audit or otherwise challenged, that a tax issue will not be raised in an IRS audit, that the amount in controversy in an IRS audit will be too little, that the IRS or other possible challengers will have too few resources to sustain the challenge, or that the IRS and the issuer or others are likely to enter into a closing agreement to resolve any federal tax issues to preserve the federal tax exemption.

"An opinion is not a guaranty of an outcome, but rather an expression of professional judgment." *See "Third-Party 'Closing' Opinions; A Report of the TriBar Opinion Committee," 53 Business Lawyer 591, 596 (*"TriBar 1998 Report"*); and see Glazer and Fitzgibbon on Legal Opinions,* at 72. Accordingly, even with an "unqualified" opinion, some residual risk exists that the court may disagree.

This risk is assumed by investors, but is generally considered so small as to require no special or additional disclosure in the disclosure document. *See* "Disclosure Matters—Disclosure Issues," below.

Of course, even when an "unqualified" opinion is rendered, failure by the issuer to comply with the relevant post-issuance requirements of the Code may cause interest on the bonds to be included in gross income. A risk also exists that the conclusions expressed in the opinion will be challenged, with possible temporary adverse consequences to the value and liquidity of the bonds. Even if an "unqualified" opinion is delivered, counsel may consider it appropriate in certain circumstances to disclose to investors in any accompanying disclosure document the potential for such challenges, as well as other facts and circumstances that may affect the validity or tax-exempt status of the bonds, such as lawsuits, court decisions, or IRS activities or positions. *See* "Disclosure Matters—Disclosure Issues—Post-Issuance Tax Compliance," "—Risk of IRS Audit," and "—Other Disclosure," below. Such disclosure is not inconsistent with rendering an "unqualified" opinion in accordance with the above discussion.

(I) Basic Opinion

The opinion that the bonds are valid general obligations means that (1) the issuer (unless it is the state itself) is a duly created and validly existing political subdivision or body politic and public instrumentality of the state, or has comparable authority as a *de facto* corporate entity, (2) the issuer has the power and authority to issue the bonds, (3) the issuance and sale of the bonds have been duly authorized by all requisite action of the issuer, (4) the bonds do not exceed any applicable limitation on indebtedness, (5) all required approvals or filings for the issuance and sale of the bonds to underwriters or other original purchasers have been obtained or have been made, and (6) the bonds are in proper form and have been duly executed and delivered—or that any defect in any of the foregoing would not affect the validity of the bonds, or has been overcome pursuant to applicable law, such as a statute of limitations. Bond counsel does not generally render an "unqualified" opinion on the basis that a defect in the validity of the bonds has been overcome through the purchase of the bonds by a purchaser for value without notice of the defect. *See* U.C.C. § 8-202. Bond counsel does not customarily set forth these conclusions explicitly, although counsel in corporate practice do set forth their equivalent. *See, e.g., TriBar 1998 Report,* at 668.

Bond counsel generally does not render its opinion unless it has concluded that the original sale of the bonds to underwriters or other original purchasers is in accordance with law, including laws relating to self-dealing by officials of the issuer; however, unless expressly stated, the opinion does not address the legal capacity of the purchasers to underwrite or invest in the bonds. These self-dealing laws are sometimes broadly stated, providing, for example, that no officer or employee of the issuer shall have any direct or indirect interest in a contract with the issuer. Counsel customarily does not require each official covered by a conflict-of-interest provision to answer a questionnaire regarding the official's relationships with bond purchasers. *Cf.* Securities and Exchange Commission Form T-1 relating to relationships of corporate officers and employees with indenture trustees. Key officers, however, do commonly certify (often in a "signature and no litigation" certificate) that, to the best of their knowledge and belief, none of a designated class of officials (*i.e.*, those covered by an applicable self-dealing prohibition) has any personal interest in any of the bond purchasers or in the project being financed. Even if the prohibition makes a sale "void" rather than "voidable," a concealed violation of a self-dealing prohibition should not affect an innocent purchaser of the bonds. In this respect, comfort may be drawn from U.C.C. § 8-202, even though (as already stated) reliance is not generally placed on it regarding matters affecting validity.

The opinion uses the word "binding," which is traditional in general obligation bond opinions, whereas the word "enforceable" is not. The word "binding" still means that remedies exist. *See generally*

TriBar 1998 Report, at 619 *et seq.* If the issuer is immune from suit on the bonds, the word "binding" may be inappropriate without qualification. An example would be the issuance of bonds by a state that has not waived sovereign immunity. If the issuer is subject to suit but a judgment cannot be paid without a legislative appropriation, use of the word "binding" may similarly be inappropriate unless the appropriation can be judicially compelled.

The word "general" means that the obligation to pay is not limited to any particular source of funds. "General" also connotes that the full faith and credit of the issuer are pledged to the payment of the bonds unless a limitation is indicated. *See* Comment (J).

(J) Property Taxes

This clause would not ordinarily apply to state bonds. For state bonds, bond counsel customarily states that the full faith and credit of the state are pledged. This clause also does not apply to all municipal general obligation bonds; in many states, for example, full faith and credit extend only to *ad valorem* taxes on real property. In some states, prior to the delivery of general obligation bonds, a tax must be levied by the governing body of the issuer for future years at a rate or in an amount sufficient to pay the principal of and interest on the bonds when due.

The significance of this clause is the elasticity of the rate that applies to the property tax base. When special categories of property (*e.g.*, motor vehicles) are exempted from the general property tax and subjected to a limited excise tax, the statement regarding the unlimited property tax remains correct.

If bonds are payable from limited property taxes, the following alternative paragraph is suggested:

> "2. All taxable property in the territory of the Issuer is subject to *ad valorem* taxation, within the limit prescribed by law, to pay the Bonds. [(*Statute*) provides (with exceptions, not including debt service on the Bonds) that the annual tax levy may not exceed ___ percent of the true value of the taxable property in the territory of the Issuer.]"

This alternative paragraph should be adapted to refer to the particular limitations applicable to the bonds. Bond counsel may appropriately refer to limited tax bonds as general obligations as long as payment is not limited to any particular source of funds (other than *ad valorem* taxes on real property); the opinion, however, should refer to the tax limitation.

(K) Security

This clause obviously does not apply to all general obligation bonds; however, summarizing in the opinion the basic security for the bonds is useful if it can be done with this degree of brevity. A more detailed statement of security (and any relevant remedies) is better placed in any accompanying disclosure document, as details may be subject to change over the life of the bonds, and the opinion, although addressing current law as of the date of issue, often accompanies the bonds throughout their term.

(L) Excludable vs. Excluded

The Committee has revised the wording of this opinion to reflect recent changes in industry practice. Specifically, rather than describing interest on the bonds as "excluded from gross income" as in the prior formulation, the model opinions state that interest on the bonds is "excludable from gross income."

Either formulation accurately indicates the result of a bond being described in Code Section 103, i.e., that the interest is excludable from gross income but is not necessarily "tax-exempt" for all purposes. For example, whereas generally the interest on the bond is excluded from gross income, other provisions of the Code may cause certain taxpayers (*e.g.*, certain property and casualty insurance companies, certain S corporations, and recipients of Social Security and Railroad Retirement benefits) to include municipal bond interest in gross income. Whether characterizing interest as "excludable" or "excluded" from gross income, bond counsel is not addressing the applicability of collateral tax consequences that may apply to particular purchasers. *See also* Comment **(P)**, Paragraph 1, for further discussion of such collateral tax consequences.

(M) Definition of Code

The Tax Reform Act of 1986, Section 2(a), provides that the Internal Revenue Title enacted August 16, 1986, "as heretofore, hereby, or hereafter amended, may be cited as the Internal Revenue Code of 1986." Nonetheless, the Committee has retained the wording of this opinion to refer to the "Internal Revenue Code of 1986, as amended" rather than the "Internal Revenue Code of 1986" in order to avoid any ambiguity or potential confusion that the absence of "as amended" may cause the uninitiated reader. This choice is not meant to suggest that the use of "the Internal Revenue Code of 1986"—without "as amended"—is incorrect.

(N) Conditions to Federal Tax Opinions

Federal tax opinions are conditioned on future compliance with all post-issuance requirements of the Code the compliance with which is necessary to maintain the excludability of interest on the bonds from gross income. Among the requirements that must be satisfied, depending on the particular transaction, are restrictions on investment of bond proceeds and other amounts, restrictions on use of bond proceeds, arbitrage rebate requirements, and the need to take "remedial action" after a "change in use" of the bond-financed facility (*e.g.*, to redeem all or an appropriate portion of the bonds if the property financed is subsequently no longer used for a purpose qualifying for tax exemption). If bond counsel is responsible for preparing or reviewing relevant portions of any accompanying disclosure document, bond counsel should recommend that such post-issuance requirements be described in such document. *See* "Disclosure Matters—Disclosure Issues—Tax Issues—Post-Issuance Tax Compliance," below.

Conditioning the federal tax opinion on future compliance with such requirements is not intended to suggest that bond counsel need not consider the legality and practicability of such compliance, or that bond counsel has any obligation for post-issuance monitoring. Indeed, absent a statement to the contrary in the opinion or any accompanying disclosure document, it should be assumed that bond counsel has no such responsibility.

An alternative to the language in the text making the federal tax opinions conditioned on future compliance is the following, in which future compliance is assumed:

> "For the purpose of rendering the opinions set forth in the preceding sentence, we have assumed compliance by the Issuer with all requirements of the Internal Revenue Code of 1986, as amended, that must be satisfied subsequent to the issuance of the Bonds in order

> that the interest thereon be, and continue to be, excludable from gross income for federal income tax purposes."

Practice varies in this area. Whether future compliance is assumed or is a condition of the opinion, bond counsel should consider the scope of ongoing compliance required, and the application of the general principle that counsel may make assumptions or conditions (*e.g.*, based on a certificate or documentation), unless bond counsel has knowledge that any such assumption or condition is false, or has knowledge of facts that, under the circumstances, would make it unreasonable so to assume. *See Principles*, III. Facts.

In the case of certain transitional refundings, in addition to referring to "the Internal Revenue Code of 1986, as amended," it may be appropriate also to reference either "its statutory predecessor" or "the Internal Revenue Code of 1954, as amended."

Some bond counsel prefer to list in the bond opinion factors that could adversely affect the excludability of interest on the bonds from gross income for federal income tax purposes. Such a listing is neither necessary nor desirable. Accordingly, the Committee makes no recommendation regarding the scope or content of any such listing. To the extent that bond counsel has responsibility for preparing or reviewing relevant portions of any disclosure document, bond counsel should suggest appropriate disclosure on this issue.

(O) Certifications and Covenants Regarding Tax Matters

The excludability of interest on the bonds from gross income for federal income tax purposes, both on the date of issuance and throughout the period during which the bonds are outstanding, will depend on (among other things) (1) the accuracy of certifications of fact made on the date of issuance and (2) continuing compliance with certain covenants by the issuer (and, in the case of conduit bonds, continuing compliance by one or more parties, including the conduit borrower, users of the facility, or guarantors). Those certifications and covenants generally are included either in the bond documents or in separate tax documents, and recite in varying levels of detail the requirements for initial and ongoing excludability of interest from gross income. The certifications and covenants not only provide a basis for bond counsel's opinion on the excludability of interest, but also provide guidance to the financing participants regarding the post-closing conduct necessary to preserve such excludability.

Customarily, the issuer and, in the case of a conduit financing, the conduit borrower, covenant to comply with all requirements of the Code in order to preserve the tax exemption. While this covenant generally is made with respect to the Code both as it exists on the date of bond issuance and as it may be modified thereafter, in some circumstances the covenant is to comply with the Code only as it exists on the date of issuance. The language in the model opinion reflects the former approach. If the latter approach to the covenant is taken, bond counsel should consider using the following alternative language:

> "The Issuer has covenanted to comply with all such requirements as in effect on the date hereof."

If, after the date of issuance, a new Code provision is adopted that applies to outstanding bonds (*i.e.*, a provision with a retroactive effective date), an issuer that made the covenant stated in the model opinion has agreed to comply with this provision, whereas an issuer subject to the covenant stated in the alternative language above has not. This difference could result in interest on the bonds of the second issuer becoming taxable. Accordingly, in a transaction with a covenant to comply with the Code only as it exists on the date of bond issuance, this point should be clearly disclosed in any accompanying disclosure document. *See also* Comment (N).

(P) Scope of Federal Tax Opinion

1. Basic Tax Opinion

The formulation of the opinion addressing the federal income tax treatment of interest on the bonds used in bond opinions prior to adoption of the Tax Reform Act of 1986 (the "1986 Act"), *i.e.*, "interest on the Bonds is exempt from federal income taxes," is now narrowed to the statement contained in the first sentence of the federal tax opinion paragraph, which conforms to the language of Code Section 103(a). This language, together with the disclaimer in the last sentence of the paragraph, is intended to eliminate any claim that this sentence addresses tax matters other than the excludability of interest on the bonds from the definition of gross income contained in Code Section 61.

Because of 1986 Act changes in the computation of the alternative minimum tax imposed on individuals and corporations by Code Section 55, the market now expects the bond opinion to address the applicability of such tax to owners of bonds. The suggested language for the federal tax opinion includes a brief statement regarding the applicability of such tax.

The inclusion of the opinions regarding the applicability of the alternative minimum tax within the scope of the federal tax opinion, together with certain other changes in federal tax law effected by the 1986 Act (*e.g.*, elimination of the deductibility by financial institutions of interest expense allocable to tax-exempt interest), raises the question of whether additional tax consequences to bond owners should also be addressed in the opinion. Certain of such tax consequences (*e.g.*, the tax treatment of Social Security and Railroad Retirement benefits, and previous limitations on deductibility of interest by financial institutions) antedate the 1986 Act and have generally been regarded as beyond the scope of the bond opinion. Bond counsel may consider recommending that such additional tax consequences (other than the applicability of the alternative minimum tax) be addressed, if at all, in any accompanying disclosure document, rather than in the bond opinion. *See* "Disclosure Matters? Disclosure Issues—Tax Issues—Additional Tax Consequences," below. The disclaimer in the final sentence of the federal tax opinion language emphasizes its limited scope.

Where appropriate, in the case of bonds determined to be "qualified tax-exempt obligations" within the meaning of Code Section 265(b)(3), the bond opinion, or a supplemental opinion of bond counsel, may also include the following statement (or only the first portion thereof):

> "The Issuer has designated the Bonds as 'qualified tax-exempt obligations' within the meaning of Code Section 265(b)(3), and, in the case of certain financial institutions (within the meaning of Code Section 265(b)(5)), a deduction is allowed for 80% of that portion of such financial institutions' interest expense allocable to interest on the Bonds."

Although not phrased as an opinion, inclusion of this statement should be made only if bond counsel has satisfied itself that the factual basis exists for the bonds to be "qualified tax-exempt obligations" and that the issuer is a "qualified small issuer" within the meaning of Code Section 265(b)(3). Further, because the foregoing statement may be taken into account by purchasers in deciding whether to purchase, and the price to pay for, the bonds, bond counsel may consider recommending that some disclosure with respect to the applicability of Code Section 265(b)(3) be included in any accompanying disclosure document. Certain bond counsel do opine on the application of Code Section 265(b)(3) and modify the above-referenced language as follows:

> "Subject to compliance by the Issuer with certain covenants, Bond Counsel is of the opinion that the Bonds are "qualified tax-exempt obligations" within the meaning of Code Section 265(b)(3) . . ."

Neither the federal tax opinion nor any accompanying disclosure normally addresses whether any bond owner, by reason of any understanding that it will sell or resell the bonds to another party, will be treated for tax purposes as a lender to the other party, rather than as the tax owner of the bonds. *See, e.g., American National Bank of Austin v. United States,* 421 F.2d 442 (5th Cir. 1970); *American National Bank of Austin v. United States,* 573 F.2d 1201 (Ct. Cl. 1978). The opinion does imply, however, that no tax ownership problem arises from the initial offering, sale, and delivery of the bonds.

2. Original Issue Discount

In the case of bonds sold at a discount upon original issuance, most bond counsel prefer to refer in the opinion only briefly, if at all, to the treatment of original issue discount as tax-exempt interest and, where bond counsel's role includes preparation or review of relevant portions of an accompanying disclosure document, to recommend inclusion of a more complete discussion in such disclosure document. For background, *see* Code Sections 1271-1275, 1286, and 1288, and Treasury Regulations Sections 1.1271-1 through 1.1275-5. The effect of treating original issue discount as interest, coupled with a corresponding basis adjustment, is to exclude from gross income for federal income tax purposes an amount that would otherwise constitute capital gain on the sale, exchange, redemption, or maturity of the bonds.

In a publicly underwritten issue, original issue discount for any particular bond is any excess of its stated redemption price at maturity over its initial offering price to the public excluding underwriters and other intermediaries at which price a substantial amount of the bonds of such maturity was sold. Code Sections 1273(a) and (b)(1). In a private placement, the original issue discount on a bond is the excess of its stated redemption price at maturity over the price paid by the first buyer. Code Sections 1273(a) and (b)(2).

When original issue discount is present, the following opinion language may be used in place of the first clause of paragraph 3 of the model opinion:

> "Interest on the Bonds (including any original issue discount properly allocable to an owner thereof) is excludable from gross income for federal income tax purposes."

For an illustrative statement regarding original issue discount that bond counsel could recommend be included in any accompanying disclosure document, *see* "Disclosure Matters—Disclosure Issues—Tax Issues—Original Issue Discount," below.

3. Arbitrage Bonds

The federal tax opinion implicitly concludes that the bonds are not arbitrage bonds within the meaning of Code Section 148(a). Whether bonds are arbitrage bonds depends in part on the issuer's reasonable expectations as of the date of issue. To establish its expectations, a nonarbitrage certification (which may be variously titled) of the issuer is required pursuant to Treasury Regulations Section 1.148-2(b)(2), unless no unspent gross proceeds will remain after the date of issue or the issue price is $1,000,000 or less. Under Treasury Regulations Section 1.148-2(b)(2)(i), a nonarbitrage certification is evidence of the issuer's expectations in establishing eligibility for, among other things, (1) the temporary periods permitted under Code Section 148(c) and (2) reasonably required reserve or replacement funds under Code Section 148(d). Such certification, however, does not establish conclusions of law or any presumptions regarding the issuer's actual expectations or their reasonableness. Ordinarily, bond counsel does not render a tax opinion unless (except as noted above) an appropriate nonarbitrage certification has been obtained. Notwithstanding the issuer's reasonable expectations, bonds can become "arbitrage bonds" under Code Section 148(a) if, for example, any required rebate is not paid, the issuer or conduit borrower intentionally uses bond proceeds or amounts characterized as "replacement proceeds" under the Treasury Regulations to acquire higher-yielding investments, or the bonds are found to have used an "abusive arbitrage device."

4. Taxable Bonds.

If interest on the bonds is not intended to be excludable from gross income for federal income tax purposes, the opinion of bond counsel will sometimes include a specific opinion to that effect. A typical opinion is as follows:

> "Interest on the Bonds is not excludable from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986."

If an opinion is required regarding state income tax, it would similarly address whether interest on the bonds is taxable for state tax purposes.

Other collateral tax consequences result from taxable interest, including the treatment of original issue discount, market discount, premium, sale or redemption, back-up withholding, treatment of foreign bondholders, and state and local taxes. These considerations should be addressed by specific language in any disclosure document accompanying the bonds. The scope and extent of such discussion varies. Alternatively or additionally, bond counsel may include a statement in the bond opinion advising prospective purchasers to consult their own tax advisors. For example, the following language could be added to the opinion:

> "Except as expressly stated above, we express no opinion regarding any other federal or state income tax consequences of acquiring, carrying, owning, or disposing of the Bonds. Owners of the Bonds should consult their tax advisors regarding the applicability of any collateral tax consequences of owning the Bonds, which may include [original issue discount,] original issue premium, purchase at a market discount or at a premium, taxation upon sale, redemption or other disposition, and various withholding requirements."

5. "Exploding" Opinions

Opinions that cease to be applicable under certain circumstances are often referred to as "exploding" opinions. In a sense, all bond opinions are exploding opinions, as the inaccuracy of various facts represented to bond counsel, or the failure of the issuer or another party to comply with the myriad tax-related covenants, could adversely affect the validity and/or tax exemption of the bonds, with possible retroactive effect. This aspect of opinions is generally well understood, and bond counsel need not make or recommend any special mention of it in opinions or disclosure documents beyond statements indicating reliance on representations of facts and the conditioning of the opinion on continuing compliance with covenants. *See, e.g.*, Comment (N). References in this report to "exploding" opinions refer not to the foregoing opinions but to opinions that, by their express terms, cease to be applicable under certain circumstances. *See* "Disclosure Matters - Disclosure Issues - Tax Issues - Exploding Opinions" for further discussion of "exploding" opinions and suggested disclosure relating thereto.

(Q) State Tax Exemptions

Generally, an opinion addresses the excludability of interest on the bonds from taxation in the state of issuance. In some states, however, reference to such treatment is made only upon express request by the underwriter or issuer. Because of the disparate nature of state legislation addressing the issue, virtually no uniformity of language exists with respect to the tax treatment of bonds for state tax purposes. Many counsel prefer to use opinion language that follows closely the applicable legislation; others use a more generic formulation.

It should be noted that, in some states, tax treatment of interest is tied to its treatment under federal tax law.

If the bonds are exempt from intangible property taxes in the state of issuance, a statement to that effect is often included in the opinion.

With respect to state income taxes, even if the applicable statute broadly states that interest is exempt from taxation within the state, the state may include it in the "measure" of corporate excise or franchise taxes. *See Connecticut Bank & Trust Co. v. Tax Commissioner,* 178 Conn. 250, 423 A.2d 883 (Conn. 1979). Indeed, if interest on U.S. Treasury obligations is included in the measure of those taxes, the state is required by federal law to include interest on state and local obligations as well. *See* 31 U.S.C. § 3124 (1983); *Memphis Bank & Trust Co. v. Garner, 459* U.S. 392 (1983). If bond interest is or may be includable in the measure of corporate excise or franchise taxes, corporate purchasers may misinterpret a statement that interest is excludable from state income taxes. In such a case, a qualification should be included.

If an opinion is given regarding state tax treatment of interest on the bonds, bond counsel may wish to include a disclaimer similar to the last sentence of the federal tax opinion in item 3 of this opinion. Some bond counsel prefer to put such tax disclaimers in a paragraph following the numbered paragraphs.

(R) Bankruptcy and Equitable Principles

The reference to bankruptcy and similar laws is limited to laws affecting creditors' rights generally. If a law would affect only one particular type of creditor, that law should be discussed or disclosed in either the disclosure document or in another place in the opinion.

An example of the possible adverse exercise of equitable principles would be judicial permission to pay essential operating expenses ahead of debt service. *See Borough of Fort Lee v. United States,* 104 F.2d 275, 284 (3rd Cir. 1939).

Many formulations of this qualification are used in bond opinions. Another form for consideration is set forth below. The bracketed language would be appropriate for an issue of conduit financing bonds in which the private party agrees to indemnify the issuer against certain liabilities.

> "The Bonds are subject to bankruptcy, insolvency, moratorium, reorganization, and other similar state and federal laws affecting the enforcement of creditors' rights generally,

and to general principles of equity[, and enforceability of the indemnification provisions of the Agreement may be limited by applicable public policy.]"

For further discussion of this paragraph, *see* Comment (Z).

(S) Opinion Regarding Disclosure Document

This statement is consistent with the general approach taken by bond counsel not to express an opinion on or to render any other advice regarding any disclosure document accompanying the bonds. The statement does not necessarily mean that bond counsel has not been engaged to review the accuracy or completeness of specific portions of any disclosure document or to render an opinion in addition to the bond opinion with respect thereto. Indeed, bond counsel's engagement now often includes (1) the preparation of summaries and descriptions of the bonds and relevant documents for inclusion in a disclosure document and (2) the rendering of an opinion, in addition to the bond opinion, to one or more specified parties, with respect to such summaries and descriptions, as well as the portions of the disclosure document describing tax and legal matters. Such an opinion usually is rendered to the underwriters, and is not included in the bond opinion. In that case, the word "herein" should be added to the disclaimer, as shown in the model opinions, to make the disclaimer accurate. Unless specifically engaged to do so, bond counsel usually does not render an opinion regarding other portions of the disclosure document, or assume any responsibility for reviewing such portions of the disclosure document. *See Disclosure Roles*—Other Opinions of Bond Counsel, at pages 159 and 160, for a discussion of the scope and content of an opinion regarding material in a disclosure document, including examples of opinion language and the need to avoid language "that implies that the document summaries include every provision of the bond documents that might be material to an investor under every circumstance."

In situations where bond counsel is not engaged to review the accuracy, completeness, or sufficiency of all or part of any accompanying disclosure document and will not be rendering any opinion or other advice with respect thereto, bond counsel may wish to include a statement to that effect in the bond opinion. While such a statement will inform investors of the limited role of bond counsel, such statement may not be an effective shield against any statutory or common law liability. *See* "Disclosure Matters," below.

Some bond counsel also include in their bond opinions a disclaimer of responsibility regarding the creditworthiness of the instrument or the issuer's ability to pay. Such disclaimers are unnecessary because bond opinions cannot reasonably be construed to reach such matters. *See Disclosure Roles*—Security Provisions, at pages 153 and 154. Factual matters bearing on credit or ability to pay properly should be addressed in any accompanying disclosure document and not in the bond opinion. The bond opinion is not intended to serve as a "prospectus" and should not be used as a disclosure document. *See* "Disclosure Matters," below.

(T) Miscellaneous

1. Contingent Fees

No reference is made in the model opinion to the financial terms on which bond counsel is retained. The same standard of care should apply in rendering the opinion, regardless of the basis for compensation. Accordingly, so long as bond counsel is applying the same standard, the basis for compensation is not material to the bond opinion and need not be disclosed therein. *See* "Disclosure Matters—Disclosure Issues—Other Disclosure—Potential Conflicts of Interest," below.

2. No-Litigation Certificate

The delivery of an "unqualified" opinion regarding validity has traditionally meant that counsel for the issuer (or a responsible officer or officers) has certified that no litigation is pending or, to such person's knowledge, threatened, affecting the validity of the bonds or, if applicable, the power of the issuer to levy and collect taxes or to provide any other security for the payment of the bonds. *Cf. Disclosure Guidelines for State and Local Government Securities* (*"GFOA Guidelines"*), published by the Government Finance Officers Association (1991), at Section XI, ¶E. The requirement of an unqualified no-litigation certificate has at times impeded financings where, notwithstanding pending or threatened litigation, no substantial basis existed for questioning the validity of or security for the bonds. As a result, a more reasonable standard has emerged, and it is considered appropriate for bond counsel to render an "unqualified" opinion regarding the validity of the bonds, notwithstanding pending or threatened litigation challenging the validity of or adversely affecting the security for the bonds, if bond counsel is satisfied that a material adverse outcome is remote and if terms of the sale permit delivery of the bonds in these circumstances. *Cf.* American Bar Association, *Statement of Policy Regarding Lawyers' Responses to Auditors' Request for Information,* 31 Bus. Law. 1709, 1713, 1723 (1976) (definition of "remoteness" in litigation situation). In reaching this conclusion, bond counsel may rely upon a "no merit" opinion of other counsel familiar with the litigation if bond counsel is satisfied regarding the competence of such other counsel through its reputation or otherwise. *See TriBar 1998 Report* at 636 *et seq.* The Committee believes that it is still advisable to recommend that the litigation be described in any accompanying disclosure document, together with an indication that a no merit opinion, if sought, was rendered and relied upon. *See GFOA Guidelines,* at Section XI, ¶A. Some bond counsel may choose to include a description of the litigation in the opinion itself.

Litigation affecting the valid existence of the issuer or the title to office of the officers acting for the issuer is not considered relevant to the opinion if the validity of and security for the bonds would not be affected by an adverse decision in such litigation. As an example, the validity of and security for bonds may be unaffected because, under applicable law, the issuer would be recognized as a *de facto* entity or the officers would be recognized as *de facto* officers. Here again, however, depending on the materiality of the litigation in other respects, describing the litigation in any accompanying disclosure document may be appropriate.

3. Securities Laws

a. Federal

In opinions rendered on general obligation bonds, common practice has been not to refer to the exemptions from registration and qualification under federal securities laws. If an opinion is required from bond counsel regarding exemption from registration under the Securities Act of 1933, and exemption of a trust indenture or equivalent document from qualification under the Trust Indenture Act of 1939, such opinion is generally given in a supplemental opinion rather than in the bond opinion and may be given by counsel to the underwriter. Such an opinion had been included in the model opinions for revenue bonds and private activity bonds in the predecessor to this report. In keeping with general current practice, however, the Committee has deleted such opinion in this report. The following language could be used for such an opinion:

> "The Bonds are exempt from registration under the Securities Act of 1933, as amended, and the [*insert term given to trust document pursuant to which Bonds are issued*] is exempt from qualification under the Trust Indenture Act of 1939, as amended."

b. State

Before rendering an opinion, bond counsel generally satisfies itself that state securities law requirements have been met regarding the original sale of the bonds by the issuer to the underwriter (or private placement purchaser). But, unless specifically engaged to do so, bond counsel does not assume responsibility for compliance with "blue sky" requirements for resale of the bonds by underwriters and dealers, or eligibility for investment by institutional investors. In states that have adopted the Uniform Securities Act, general obligation bonds are generally exempt from securities registration, although the filing of offering literature may be required. Unif. Sec. Act (1985 with 1988 Amendments) § 401(b)(1), 7B U.L.A. (1994 Cum.) 105; *see, e.g.*, Mass. Gen. Laws Ann. ch. 110A, § 403 (West 1982). Under the Uniform Securities Act, brokers or dealers executing transactions in municipal bonds are not exempt from broker-dealer registration, but the issuer is not treated as a broker-dealer. Unif. Sec. Act (1985 with 1988 Amendments) § 101(2)(ii), 7B U.L.A. (1994 Cum.) 75.

For more information on state securities laws, including consideration of various types of issues (*e.g.*, hospital bonds and single family housing bonds), reference should be made to *Blue Sky Regulation of Municipal Securities*, published by NABL (1995), and, for the subsequent impact of the National Securities Markets Improvement Act of 1996 on blue sky regulation of other states' securities, discussion drafts of *Model Blue Sky Memoranda for Municipal Securities* (2001) and *The Effects of NSMIA on Blue Sky Requirements Applicable to Municipal Securities* (October 14, 2002). The discussion drafts may be found on NABL's website.

4. Credit Enhancement

If bond insurance, a letter of credit, or other credit enhancement secures the bonds, reference thereto is sometimes made in the bond opinion. This practice is particularly true in the case of a direct-pay letter of credit. To address tax concerns resulting from a possible "reissuance" of the bonds if a change occurs in the credit enhancement, bond counsel often takes an exception in the opinion with respect to the excludability of interest on the bonds after such a change. The purpose of such an exception is generally to alert purchasers to the need to retest for the continued tax-exemption of interest on the bonds after such a change in credit enhancement. *See also* discussion in Comment (P), Paragraph 5, and "Disclosure Matters" with respect to "exploding" opinions.

II. REVENUE BONDS (U)

MODEL OPINION

[Note: Letters in parentheses refer to Commentary immediately following this opinion. *See* the Commentary following the General Obligation Bonds Opinion for additional notes as appropriate.]

(Letterhead of Bond Counsel)
(Date)

(Addressee)

(Salutation)

(Caption)

We have acted as bond counsel to ______ in connection with the issuance by (*Name of Issuer*) (the "Issuer") of $________________ (*Title of Bonds*) Bonds dated ______________ (the "Bonds"). In such capacity, we have examined such law and such certified proceedings, certifications, and other documents as we have deemed necessary to render this opinion.

The Bonds are issued pursuant to (*Enabling Act*) and a Revenue Bond Resolution (the "Resolution") of the Issuer adopted ________________. **(V)** Under the Resolution, the Issuer has pledged certain revenues (the "Revenues") for the payment of principal of, premium (if any) and interest on the Bonds when due.

Regarding questions of fact material to our opinion, we have relied on the representations of the Issuer contained in the Resolution, and in the certified proceedings and other certifications of public officials and others furnished to us, without undertaking to verify the same by independent investigation.

Based on the foregoing, we are of the opinion that, under existing law:

1. The Issuer is validly existing as a body corporate and politic and public instrumentality of (*State*) with the power to adopt the Resolution, perform the agreements on its part contained therein, and issue the Bonds. **(W)**

2. The Resolution has been duly adopted by the Issuer, **(W)** and constitutes a valid and binding obligation of the Issuer enforceable against the Issuer. **(X)**

3. The Resolution creates a valid lien on the Revenues and other funds pledged by the Resolution for the security of the Bonds on a parity with other bonds (if any) issued or to be issued under the Resolution. **(Y)**

4. The Bonds have been duly authorized and executed by the Issuer, **(W)** and are valid and binding limited obligations of the Issuer, payable solely from the Revenues and other funds provided therefor in the Resolution.

5. Interest on the Bonds is excludable from gross income for federal income tax purposes and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations; however, such interest is taken into account in determining adjusted current earnings for the purpose of computing the alternative minimum tax imposed on certain corporations. The opinion set forth in the preceding sentence is subject to the condition that the Issuer complies with all requirements of the Internal Revenue Code of 1986, as amended, that must be satisfied subsequent to the issuance of the Bonds in order that the interest thereon be, and continue to be, excludable from gross income for federal income tax purposes. The Issuer has covenanted to comply with all such requirements. Failure to comply with certain of such requirements may cause interest on the Bonds to be included in gross income for federal income tax purposes retroactively to the date of issuance of the Bonds.

6. [Opinion regarding state tax exemption, if any.]

The rights of the owners of the Bonds and the enforceability of the Bonds and the Resolution are limited by bankruptcy, insolvency, reorganization, moratorium, and other similar laws affecting creditors' rights generally, and by equitable principles, whether considered at law or in equity. (Z)

We express no opinion [herein] regarding the accuracy, adequacy, or completeness of the [disclosure document] relating to the Bonds, or regarding the perfection or priority of the lien on Revenues or other funds created by the Resolution. (Y). We note that, unless perfected, the lien on Revenues may not be effective. Further, we express no opinion regarding tax consequences arising with respect to the Bonds other than as expressly set forth herein.

[This opinion is given as of the date hereof, and we assume no obligation to revise or supplement this opinion to reflect any facts or circumstances that may hereafter come to our attention, or any changes in law that may hereafter occur.]

Very truly yours,

COMMENTARY

(U) Revenue Bonds

In its current form, this opinion is applicable only to revenue bonds that are not private activity bonds; however, bond counsel preparing an opinion for revenue bonds that are private activity bonds, but not conduit financing bonds, may wish to start with this form, modifying paragraphs 5 and 6 (relating to the excludability of interest on the bonds) as indicated in Part III.

(V) Resolution or Trust Agreement

If the bonds are secured by a trust agreement, a trust indenture, or other document, rather than by a resolution or ordinance, the references in the opinion should be modified appropriately.

(W) Subsidiary Conclusions

Most corporate opinions state that the transaction (including performance of obligations undertaken by the issuer) does not violate "any agreement, instrument, order, writ, judgment, or decree known to us to which the Corporation is a party or is subject." An alternative formulation of the opinion indicates that the transaction does not breach or result in a default under any agreement or instrument specifically identified on an attached schedule. *See TriBar 1998 Report,* at 670, ¶2(a). If this opinion is to be given by counsel in a municipal revenue bond transaction, it may be preferable to have it given by local or general counsel most familiar with the affairs of the issuer rather than by bond counsel. If this opinion is to be rendered by bond counsel, it may be preferable to include it in a supplemental opinion addressed to the underwriters.

(X) Enforceability

In a revenue bond transaction, the issuer ordinarily undertakes a number of obligations beyond the basic promise to pay, such as obligations to operate and maintain the revenue-producing facility or system in a sound and economical manner, to charge and collect sufficient rates to operate and maintain the facility or system, and to pay the bonds. These obligations are set forth in the resolution, a bond indenture, or a similar document. With respect to these obligations, "enforceable" probably has the same meaning as "enforceable in accordance with its terms." *See TriBar 1998 Report,* at 619-620. Some opinion recipients prefer to have the words "in accordance with its terms" added to make this explicit. *See also* the discussion of "binding" in Comment (I).

In some situations, bond counsel may not be satisfied that all significant terms of the resolution are enforceable. In such a case, the opinion may be appropriately qualified, or each potentially unenforceable provision may itself be qualified, such as by providing that it shall be applicable "to the extent permitted by law." Alternatively, the opinion concerning the enforceability of the resolution could be deleted from the bond opinion and included in a supplemental opinion, where additional qualifications to enforceability are more commonly accepted.

(Y) Uniform Commercial Code

The Uniform Commercial Code (the "U.C.C.") was revised in 1998 to provide that, effective July 1, 2001 (or 2002 under a transition rule) and contrary to the 1972 revision, the creation, perfection, priority, and enforcement of security interests granted by governmental units (including their bond issuing instrumentalities) are governed by Article 9 of the U.C.C., except to the extent that another statute of the governmental unit's state expressly governs such matters. *See* U.C.C. §§ 9-109(c)(2) and (3). Although all states have enacted the 1998 revisions, more than half the states enacted non-conforming amendments that continue to exclude from the scope of U.C.C. Article 9 security interests granted by governmental units.

Revenue bonds have traditionally been issued under laws that expressly authorize a lien on future revenues. This lien is frequently called a "pledge" even though at common law a pledge is made only by a transfer of possession of the collateral to the pledgee. *Black's Law Dictionary,* at page 1153 (6th Ed. 1990). To avoid any argument that the pledge of future revenues is subject to the filing of a financing statement under U.C.C. Article 9, the enabling laws often expressly provide that the pledge is effective or enforceable without any such filing. If the enabling or other statute states that the pledge is effective or enforceable, it effectively pre-empts U.C.C. Article 9 regarding this issue.

If U.C.C. Article 9 applies and the bond enabling or other statute does not expressly state that the pledge is enforceable, bond counsel will need to satisfy itself that the pledge will be enforceable under Article 9. To do so, bond counsel generally must conclude that the resolution describes the pledged property and that the issuer then has rights to the pledged property. For a description of special issues raised by "net revenue" pledges, *see* Report of the National Association of Bond Lawyers Opinions and Documents Committee Re: Revised Article 9 of the Uniform Commercial Code, dated July 17, 2000. That report can be viewed on NABL's website. If the issuer does not have rights to the pledged property (*e.g.*, in the case of future revenues the rights to which have not yet been earned by the delivery of goods or services), the lien enforceability opinion may be qualified by adding a phrase such as "as and to the extent that the issuer obtains rights to the Revenues and funds."

It is not uncommon for the title of bonds to imply the priority position of the pledge of revenues made to secure the bonds (*e.g.*, "Senior" or "Prior" Lien Revenue Bonds). Unless the perfection and priority of the pledge are governed by the bond enabling or other state statute, the perfection and priority of the pledge will be governed by U.C.C. Article 9, to the extent applicable. Under the U.C.C., depending on the form, possession, and location of the revenues, perfection and priority could be governed by the law of other states and could depend not only on the filing of a conforming financing statement but also on the existence of possession or control of the revenues by bondholders or their representatives (in the case of revenues in the form of money or a deposit account balance). *See* U.C.C. §§ 9-301-307, 312(b). In view of the possible complexity of perfection and, especially, priority opinions, the model opinion addresses only the creation of the bond pledge. To avoid an implied perfection and priority opinion by reference to the bond title, an express disclaimer is recommended. If perfection opinions are given, it is suggested that they be rendered by the issuer's other counsel or be included in a supplemental opinion of bond counsel addressed to the underwriter. The Committee considers it inappropriate to request a priority opinion in most circumstances, since priority is usually addressed by bond resolutions, and such opinions are complex and add little to a reading of U.C.C. Article 9. To avoid any unwarranted inference that the lien opinion is intended to address perfection or priority, the model opinion expressly disclaims any opinion on such issues.

(Z) Bankruptcy and Related Matters

In general, by virtue of Section 552 of the federal Bankruptcy Code, a security interest is ineffective regarding revenues received after the filing of a bankruptcy case unless: (i) the revenues are proceeds, rents, or products of property acquired before the filing of the case, (ii) a perfected pre-petition security interest in such property and proceeds, rents, or products thereof, as applicable, was granted, and (iii) the security interest or the transfer of revenues under the security interest cannot otherwise be avoided by the trustee in bankruptcy. *See* Comment **(Y)**. *See also In re County of Orange,* 179 B.R. 185, 193 (Bkrtcy.

C.D. Cal. 1995) (remanded 189 B.R. 499 (C.D. Cal. July 13, 1995)). Under Section 928 of the Bankruptcy Code, enacted in 1988, a lien on post-petition revenues is nevertheless effective if the lien is on net "special revenues," other than betterment assessments, of the project or system from which the revenues are derived. "Special revenues" are defined by Section 902(2) of the Bankruptcy Code as follows:

> "(A) receipts derived from the ownership, operation, or disposition of projects or systems of the debtor that are primarily used or intended to be used primarily to provide transportation, utility, or other services, including the proceeds of borrowings to finance the projects or systems; (B) special excise taxes imposed on particular activities or transactions; (C) incremental tax receipts from the benefited area in the case of tax-increment financing; (D) other revenues or receipts derived from particular functions of the debtor, whether or not the debtor has other functions; or (E) taxes specifically levied to finance one or more projects or systems, excluding receipts from general property, sales, or income taxes (other than tax-increment financing) levied to finance the general purposes of the debtor."

If the pledged revenues are neither "special revenues" nor proceeds of property that is the subject of a perfected pre-petition security interest that cannot be avoided by a trustee in bankruptcy, the pledge will be ineffective if a bankruptcy petition is filed.

The Committee does not consider it necessary to include in this paragraph of the opinion a reference to the state or federal "police" power. Municipalities are inherently subject to these police powers. Where the exercise of the police power takes the form of a moratorium or similar act, it is covered by this paragraph of the opinion as written. An exercise of the police power may also take the form of a regulation of land use, utility rates, or the like. Regulatory laws of this character are not likely to affect the legal validity or enforceability of general obligation bonds (although they may affect the ability to pay); in the case of revenue bonds, such regulatory laws may affect validity or enforceability. *See* Comment (X).

III. PRIVATE ACTIVITY BONDS (AA)

MODEL OPINION

[Note: Letters in parentheses refer to the Commentary immediately following this opinion. *See* the Commentaries following the General Obligation Bonds Opinion and the Revenue Bonds Opinion for additional notes as appropriate. In this regard, note that Comments **(E)** and **(P)** include material specifically relevant to conduit private activity bonds.]

(Letterhead of Bond Counsel)
(Date)

(Addressee)

(Salutation)

(Caption)

We have acted as bond counsel to ______ in connection with the issuance by (*Name of Issuer* (the "Issuer") of $____________ (*Title of Bonds*) Bonds dated ____________ (the "Bonds"). In such capacity, we have examined such law and such certified proceedings and other documents as we have deemed necessary to render this opinion.

The Bonds are issued pursuant to (*Enabling Act*), a Trust Indenture (the "Indenture") between the Issuer and _________, as Trustee (the "Trustee"), and a resolution (the "Resolution") of the Issuer authorizing the issuance and sale of the Bonds. The Issuer and (*Name of Company*) (the "Company") have entered into a loan agreement (the "Loan Agreement") pursuant to which the Issuer is lending the proceeds of the Bonds to the Company. **(BB)** Under the Loan Agreement, the Company has covenanted to make payments to the Issuer to be used to pay when due the principal of, premium (if any) and interest on the Bonds, as well as other payments and revenues (collectively, the "Revenues"). Under the Indenture, the Issuer has pledged and assigned its rights in and to the Loan Agreement and the Revenues (except certain rights to indemnification, reimbursements, and administrative fees) as security for the Bonds. The Bonds are payable solely from the Revenues. **(CC)**

We note that various issues concerning [specify legal issues] are addressed in the opinion of [identify counsel and their relationship] provided to [identify addressee], and we express no opinion with respect to those issues. **(DD)**

Regarding questions of fact material to our opinion, we have relied on representations of the Issuer and the Company contained in the Indenture and the Loan Agreement, and the certified proceedings and other certifications of public officials and others furnished to us, including certifications furnished to us by or on behalf of the Company, without undertaking to verify the same by independent investigation.

Based on the foregoing, we are of opinion that, under existing law:

1. The Issuer is validly existing as a body corporate and politic and public instrumentality of (*State*) with the power to enter into and perform its obligations under the Indenture and the Loan Agreement and to issue the Bonds.

2. The Indenture has been duly authorized, executed, and delivered by the Issuer, and is a valid and binding obligation of the Issuer enforceable against the Issuer. **(EE)** The Indenture creates a valid lien on the Revenues, the other funds pledged by the Indenture as security for the Bonds, and the rights of the Issuer under the Loan Agreement (except certain rights to indemnification, reimbursements, and administrative fees) on a parity with other bonds (if any) issued or to be issued under the Indenture. **(FF)**

3. The Bonds have been duly authorized and executed by the Issuer, and are valid and binding limited obligations of the Issuer, payable solely from the Revenues.

[The following paragraph should be used if the bonds are "qualified small issue bonds" within the meaning of Code Section 144(a), "exempt facility bonds" within the meaning of Code Section 142, "mortgage revenue bonds" that are exempt under Code Section 143, "qualified student loan bonds" within the meaning of Code Section 144(b), or "qualified redevelopment bonds" within the meaning of Code Section 144(c):]

4. Interest on the Bonds is excludable from gross income for federal income tax purposes, except for interest on any Bond for any period during which such Bond is held by a "substantial user" of the facilities financed by the Bonds, or a "related person" within the meaning of Section 147(a) of the Internal Revenue Code of 1986, as amended (the "Code"); **(GG) (HH)** however, interest on the Bonds is an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. The opinion set forth in this paragraph is subject to the condition that the [Issuer and the Company] comply with all requirements of the Internal Revenue Code of 1986, as amended, that must be satisfied subsequent to the issuance of the Bonds in order that interest thereon be, and continue to be, excludable from gross income for federal income tax purposes. The [Issuer and the Company] have covenanted to comply with all such requirements. Failure to comply with certain of such requirements may cause interest on the Bonds to be included in gross income for federal income tax purposes retroactively to the date of issuance of the Bonds.

[The following paragraph should be used if the bonds are qualified 501(c)(3) bonds within the meaning of Code Section 145:]

4. Interest on the Bonds is excludable from gross income for federal income tax purposes **(II)** and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations; however, for the purpose of computing the alternative minimum tax imposed on certain corporations, such interest is taken into account in determining adjusted current earnings. The opinion set forth in this paragraph is subject to the condition that the [Issuer and the Company] comply with all requirements of the Internal Revenue Code of 1986, as amended, that must be satisfied subsequent to the issuance of the Bonds in order that interest thereon be, and continue to be, excludable from gross income for federal income tax purposes. The [Issuer and the Company] have covenanted to comply with all such requirements. Failure to comply with certain of such requirements may cause interest on the Bonds to be included in gross income for federal income tax purposes retroactively to the date of issuance of the Bonds.

5. [Opinion regarding state tax exemption, if any.]

The rights of the owners of the Bonds and the enforceability of the Bonds and the Indenture are limited by bankruptcy, insolvency, reorganization, moratorium, and other similar laws affecting creditors' rights generally, and by equitable principles, whether considered at law or in equity.

We express no opinion [herein] regarding the accuracy, adequacy, or completeness of the [disclosure document] relating to the Bonds, or regarding the perfection or priority of the lien on Revenues or other funds created by the Indenture. Further, we express no opinion regarding tax consequences arising with respect to the Bonds other than as expressly set forth herein.

[This opinion is given as of the date hereof, and we assume no obligation to revise or supplement this opinion to reflect any facts or circumstances that may hereafter come to our attention, or any changes in law that may hereafter occur.]

Very truly yours,

COMMENTARY

(AA) Private Activity Bonds

This opinion is applicable to private activity bonds issued in a conduit financing where the issuer loans the bond proceeds to a third-party conduit borrower. With appropriate revisions, it should also suffice for conduit financings in which the issuer leases or sells the bond-financed facilities to the third-party conduit beneficiary. Non-conduit bonds may also be private activity bonds because of private business use of bond proceeds and either private security or payment supporting the bonds, as provided in Code Section 141. For such general obligation bonds or revenue bonds that are private activity bonds, the General Obligation Bonds Opinion or Revenue Bonds Opinion should be used, but with paragraph 4 of this opinion substituted for the respective paragraph addressing the federal income tax treatment of interest on the bonds.

(BB) Documentation

Documentary formats used in private activity bond financing vary considerably, and include: (1) a trust agreement between the issuer and the trustee, a loan agreement, lease or installment sale agreement between the issuer and the conduit borrower, and a separate security agreement or mortgage between the issuer and the conduit borrower, (2) a trust agreement between the issuer and the trustee, and a loan and security agreement between the issuer and the conduit borrower, and (3) a single trust, loan, and security agreement among the issuer, the trustee, and the conduit borrower. This opinion assumes format (2). If a different format is used, appropriate changes should be made. Representative language for an opinion in a transaction utilizing a multi-document format is as follows:

> The Bonds are issued pursuant to (*Enabling Act*) and a Trust Agreement (the "Agreement") among the Issuer, (*Name of Company*) (the "Company"), and _________, as Trustee (the "Trustee"). Under the Agreement, the Company has agreed to make payments to be used to pay when due the principal of, premium (if any) and interest on the Bonds, and such payments and other revenues under the Agreement (collectively, the "Revenues"), and the rights of the Issuer under the Agreement (except certain rights to indemnification, reimbursements, and administrative fees) are pledged and assigned by the Issuer as security for the Bonds. The Bonds are payable solely from the Revenues.

Additional paragraphs are added to the opinion addressing the authenticity and enforceability of the additional documents. Also, where other documents secure the conduit borrower's obligations or the bonds (*e.g.*, a guaranty or letter of credit), reference should be made to those documents.

(CC) Right To Receive Revenues

Where bond counsel concludes that the power to pledge revenues includes the power to assign the rights under the trust agreement (or other financing document) to receive the revenues, it may be useful to include an assignment. An assignment should overcome the problem created by Sections 547 and 552 of the Bankruptcy Code in the event of bankruptcy of the issuer. *See* Comment (Z). Even without an assignment, however, this problem is probably not significant in a conduit financing. Legislative history to the Bankruptcy Code indicates that, in a conduit financing, the issuer's rights and obligations would not be treated in bankruptcy as property and obligations of the issuer subject to its bankruptcy proceeding. *See* S. Rep. No. 989, 95th Cong., 2d Sess., 5859-86, reprinted in 1978 *U.S. Code Cong. & Ad. News*, 5859-86.

(DD) Opinions of Other Counsel

These references to opinions of other counsel are included both for information and to make clear that bond counsel is not rendering certain opinions. Such references do not express reliance on or concurrence in the opinions of other counsel, and are not intended to have the meanings attributed to an opinion that expresses reliance on the opinion of another. *Cf. TriBar 1998 Report,* at 636 *et seq.* (concerning reliance on the opinion of other counsel). Regarding the title to mortgaged property (if any), reference may be made to a title policy in place of or in addition to a title opinion. In a conduit financing such as that contemplated by the Private Activity Bonds Opinion, counsel for the conduit borrower usually renders an opinion regarding (1) the due authorization, execution, and delivery of documents by the conduit borrower, (2) the legal, valid, and binding nature of documents to which the conduit borrower is a party, and (3) where "qualified 501(c)(3) bonds" are involved, that the conduit borrower is an organization described in Code Section 501(c)(3). Bond counsel is generally an addressee of such opinion. Increasingly, bond counsel expresses in the bond opinion reliance on such Section 501(c)(3) opinion of other counsel.

In general opinion practice, a primary opinion giver's responsibility for the conclusions in an opinion of other counsel depends on how the reliance is stated. The TriBar 1998 Report states that an opinion reciting that counsel is relying on another opinion (*e.g.*, a bond opinion reciting that bond counsel is relying on a Section 501(c)(3) opinion provided by the conduit borrower's counsel) means that such other opinion addresses the legal issues on which counsel is purporting to rely, and that, in the professional judgment of the counsel rendering the opinion, reliance on that other opinion is reasonable. *See TriBar 1998 Report,* at 636-639. By contrast, an opinion reciting that the other opinion is "satisfactory in form and substance" or "reasonable in form and substance" may be construed as implying concurrence with the opinion being reviewed. *See Disclosure Roles,* at 164 and 165. The use of assumptions in lieu of reliance is developing in general opinion practice. Notwithstanding the above general guidelines, little guidance exists regarding how a court or a jury would interpret these different alternatives. Accordingly, bond counsel relying on an opinion of another counsel should develop the language used in its opinion with great care, and should perform its diligence functions accordingly. In rendering the bond opinion, if bond counsel relies on or assumes, but does not itself adopt, the conclusions expressed by other counsel, that fact should be disclosed clearly to prospective bond purchasers. For a more complete discussion of the issues related to reliance on the opinions of other counsel, *see Glazer and Fitzgibbon on Legal Opinions,* at 129-145.

(EE) Assumptions Regarding Other Parties

An opinion that an agreement is binding on one party implicitly assumes that it is binding on the other parties to the extent necessary to satisfy requirements of mutuality. *See TriBar 1998 Report,* at 615.

(FF) Revenue Pledge

This opinion assumes that only the issuer has granted a security interest under the agreement. *See* Comment (Y). If the conduit borrower pledges property as security for the bonds, its counsel more commonly addresses the enforceability and priority of that pledge.

(GG) Substantial User and Related Person Exception

The "substantial user" and "related person" exception set forth in Code Section 147(a) is inapplicable to mortgage revenue bonds under Code Section 143, and to qualified student loan bonds under Code Section 144(b), and should be omitted from the opinion with respect to such bonds.

(HH) $10,000,000 and $40,000,000 Limitations

Some bond counsel also prefer to specify exceptions for the $10,000,000 and $40,000,000 limitations of Code Section 144(a), in which case the following language may be added:

> ", and except that the Company or another person, by taking action after the date hereof that causes the $10,000,000 limitation set forth in Code Section 144(a)(4) or the $40,000,000 limit set forth in Code Section 144(a)(10) to be exceeded, may cause interest on the Bonds to be included in gross income (retroactively to the date hereof, in the case of the $40,000,000 limitation) for federal income tax purposes."

(II) $150,000,000 Limitation

Although Code Section 145(b)(7) has made the $150,000,000 limitation inapplicable to most qualified 501(c)(3) new money issues, the $150,000,000 limitation continues to apply to many qualified 501(c)(3) bond issues, or portions thereof. For such financings, some bond counsel prefer to specify an exception for the $150,000,000 limitation, in which case the following language may be added:

> ", except that the Company or another person, by taking action after the date hereof that causes the $150,000,000 limitation set forth in Code Section 145(b) to be exceeded, may cause interest on the Bonds to be included in gross income retroactively to the date hereof. Moreover, such interest is not an item of tax preference . . . ."

IV. DISCLOSURE MATTERS

A. General

Municipal bonds are customarily sold in public offerings with a disclosure document typically referred to as an "Official Statement"—a bond prospectus—the purpose of which is to provide information about both the bonds being offered and the credit behind the payment of such bonds. A similar document, sometimes more limited in scope, often is used in private placements or other limited offerings.

The disclosure document is customarily a document of the issuer, although practice varies widely regarding which party drafts it. It is the "selling document" under both federal and state securities laws. As such, its purposes include making appropriate disclosure to investors. The discussion below is intended to assist counsel in identifying issues to consider in preparing or reviewing any portions of the disclosure document relevant to either the role or the opinion of bond counsel. A general discussion of the applicability of federal and state securities laws to bond offerings is beyond the scope of this report. The discussion below is not intended to identify or create standards for disclosure. In particular, the illustrative language is not intended to imply that the particular issue discussed always requires disclosure, or that the language suggested is always appropriate. Disclosure, as is constantly acknowledged, should reflect the particular facts and circumstances of the bond financing.

B. Role of Bond Counsel

Bond counsel does not customarily assume responsibility for the preparation of the disclosure document or the delivery of any opinion regarding its accuracy and completeness, although bond counsel may be retained to play a larger role. Bond counsel's engagement should reflect the limits on its responsibility for information in the disclosure document. Material in *Engagement Letters,* and in *Disclosure Roles*—Practical Considerations—Disclaimers and Limitation in Engagement Letters, provides useful insights and suggestions regarding the ability of bond counsel to limit its responsibility for information in the disclosure document. Familiarity with such material should sensitize bond counsel to appropriate actions needed to clarify its role and to limit liability for matters for which it does not assume responsibility.

Bond counsel does, however, customarily either prepare or review specific portions of the disclosure document. These portions may include the description of the bonds and their security, descriptions of certain aspects of the bond opinion and the tax-exempt status of the bonds, and summaries of the basic financing documents. Bond counsel in many cases delivers a separate or supplemental opinion to the underwriter regarding these sections. While its language varies significantly, the supplemental opinion usually addresses the accuracy of such sections. In most instances, the proposed form of the bond opinion (but not the supplemental opinion) is attached as an exhibit to the disclosure document.

When authorized to be shared with investors or to be printed on the bonds, the bond opinion itself may be viewed as a statement made in connection with the purchase or sale of securities, so that any material misstatement or materially misleading statement in the opinion could be actionable as a primary violation of Rule 10b-5. Even when bond counsel is not the drafter of language used to describe the opinion in the disclosure document, bond counsel appropriately may insist that any description of its opinion and role be accurate and complete.

C. Disclosure Issues

The following are areas where disclosure of opinion-related issues in the disclosure documents may be appropriate. This list is not intended to be comprehensive, and the appropriateness or extent of disclosure of any issue will depend on the facts and circumstances of a particular transaction. Disclosure in offering documents need not be limited to those items required under a Rule 10b-5 standard. In addition, if an "unqualified" opinion is to be delivered by bond counsel regarding the validity and tax-exempt status of the bonds, no special or additional disclosure is generally necessary with respect to the matters addressed in the opinion. *But see* "Tax Issues—Post-Issuance Tax Compliance," below.

1. Description of Opinion and Role of Bond Counsel.

The bond opinion is customarily referenced in a section variously titled "Legal Matters," "Legal Opinions," or "Bond Counsel Opinion." As discussed below, matters relating to the opinion regarding tax exemption are frequently addressed in a separate section, such as "Tax Matters" or "Tax Exemption."

To ensure that bond counsel's limited disclosure role is made clear, this section often contains language indicating the limited role of bond counsel and reflecting the specific language of the bond opinion, as suggested in the model opinions, disclaiming responsibility for the general accuracy and adequacy of the disclosure document. The scope of this language may depend on whether the form of the bond opinion is attached to the disclosure document. The following is illustrative of language used:

> "The opinion of bond counsel will be limited to matters relating to the authorization and validity of the Bonds and the tax-exempt status of interest thereon, as described in the section "Tax Matters," and will make no statement regarding the accuracy and completeness of this [disclosure document]."

As discussed more fully below, and particularly where such ideas are expressed in the bond opinion, disclosure may include the fact that the bond opinion speaks only as of its date, and that bond counsel is not retained to monitor compliance by the parties after issuance. In addition, the limited assurance of a legal opinion (in contrast to a guaranty) is sometimes disclosed in language substantially similar to the following:

> "Bond Counsel's opinions are based on existing law, which is subject to change. Such opinions are further based on factual representations made to Bond Counsel as of the date thereof. Bond Counsel assumes no duty to update or supplement its opinions to reflect any facts or circumstances that may thereafter come to Bond Counsel's attention, or to reflect any changes in law that may thereafter occur or become effective. Moreover, Bond Counsel's opinions are not a guarantee of a particular result, and are not binding on the IRS or the courts; rather, such opinions represent Bond Counsel's professional judgment based on its review of existing law, and in reliance on the representations and covenants that it deems relevant to such opinions."

An alternative to the final sentence above is as follows:

> "The legal opinions to be delivered concurrently with the delivery of the Bonds express the professional judgment of the attorneys rendering the opinions regarding the legal issues expressly addressed therein. By rendering a legal opinion, the opinion giver does not become an insurer or guarantor of the result indicated by that expression of professional judgment, of the transaction on which the opinion is rendered, or of the future performance of parties to the transaction. Nor does the rendering of an opinion guarantee the outcome of any legal dispute that may arise out of the transaction."

If this clarification is not included in the section that describes the tax opinion, a cross-reference to it may be included in that section.

2. Tax Issues

a. Post-Issuance Tax Compliance

As discussed above in Comment (N), "Conditions to Federal Tax Opinion," bond counsel's federal tax opinion is limited to existing law, and is conditioned on the assumption of future compliance with all post-issuance requirements of the Code applicable to the bonds. Federal tax law in the last two decades, especially provisions of the 1986 Act, has vastly complicated the qualifications for tax-exempt status, and multiplied the circumstances in which tax exemption can be lost subsequent to issuance. This loss of tax exemption may be applied retroactively to the date of issuance. The disclosure document customarily includes disclosure regarding the existence of the post-closing risk of loss of tax exemption.

Where, as with the model opinion, the bond opinion does not specify the post-issuance compliance by which the opinion is qualified, the disclosure document typically does so in the "Tax Matters" section, or by cross-references to summaries of the tax compliance covenants. This section may refer to post-issuance concerns involving proper use of bond proceeds, rebate and capital expenditure violations, change in use of the bond-financed facility, *etc.*, but may also include more specific requirements depending on the type of bonds offered (*e.g.*, multi-family or single-family housing, 501(c)(3) financings). Such disclosure may be tailored to the specific post-issuance compliance requirements applicable to the type of bond issue being sold. In addition, particularly where such ideas are expressed in the bond opinion, the disclosure appropriately may point out that the bond opinion speaks only as of its date, and that, in most cases, bond counsel is not retained to monitor compliance by the parties after issuance. The following is one example of disclosure for a 501(c)(3) bond issue:

> "The Internal Revenue Code and the regulations promulgated thereunder contain a number of requirements that must be satisfied subsequent to the issuance of the Bonds in order for interest on the Bonds to be and remain excludable from gross income for purposes of federal income taxation. Examples include: the requirement that the Borrower maintain its status as an organization exempt from federal income taxation by reason of being described in Code Section 501(c)(3); the requirement that the Issuer rebate certain excess earnings on proceeds and amounts treated as proceeds of the Bonds to the United States Treasury; restrictions on investment of such proceeds and other amounts; and restrictions on the ownership and use of the facilities financed with proceeds of the Bonds. The foregoing is not intended to be an exhaustive listing of the post-issuance tax compliance requirements of the Internal Revenue Code, but is illustrative of the requirements that must be satisfied by the Issuer and the Borrower subsequent to issuance of the Bonds to maintain the exclusion of interest on the Bonds from income for federal income taxation purposes. Failure to comply with such requirements may cause interest on the Bonds to be included in gross income retroactively to the date of issuance of the Bonds. The Issuer and the Borrower have covenanted in the Indenture and the Loan Agreement to comply with these requirements. The opinion of Bond Counsel delivered on the date of issuance of the Bonds is conditioned on compliance by the Issuer and the Borrower with such requirements, and Bond Counsel has not been retained to monitor compliance with requirements such as described above subsequent to the issuance of the Bonds."

In appropriate circumstances and when consistent with the financing documents, the following language may be inserted into this paragraph:

> "The Indenture, however, does not require the Issuer to redeem the Bonds or to pay any additional interest or penalty in the event that interest on the Bonds becomes taxable."

If the disclosure document contains a "Bondholder Risks" section, the following language may be used:

> "For information with respect to events occurring subsequent to issuance of the Bonds that may require that interest on the Bonds be included in gross income of the holders of the Bonds for purposes of federal income taxation, *see* "TAX MATTERS" herein."

While all bonds are subject to loss of tax exemption for, as an example, failure to pay rebate, certain types of bonds involve specific requirements. This disclosure is usually accomplished by repeating the language from the bond opinion regarding post-issuance compliance and the possible consequences of failure to comply.

If the covenants of the issuer or other party to meet the requirements necessary to maintain tax exemption are limited to the requirements under existing law, consideration should be given to disclosing this fact.

b. Reliance

In the case where one firm delivers the validity opinion and another the federal tax opinion, disclosure may indicate that the firm's federal tax opinion relies on the validity opinion of the other firm, as federal tax exemption is dependent on the bonds or other obligations having been validly issued. Any additional reliance may also merit disclosure. One example is the reliance by bond counsel, in rendering its tax opinion, on the opinion of other counsel regarding the status of a conduit borrower as an "exempt organization" under Code Section 501(c)(3). Indeed, disclosure may be appropriate in any case where bond counsel is relying on any other counsel for any matter essential to the conclusion of tax exemption. This issue frequently arises in connection with certificates of participation ("COPs") in government leases where special tax counsel sometimes relies on the opinion of a local government attorney. If the opinion being relied on includes material qualifications or other limitations different from those included in the bond opinion, such other qualifications or limitations should be disclosed.

c. "Exploding" Opinions

As noted in Comment (P), paragraph 5, opinions that cease to be applicable under certain circumstances are often referred to as "exploding" opinions. Legal practice in the area of "exploding" opinions is still evolving. Two examples of language for "exploding" opinions currently used by some bond counsel are presented below. The Committee takes no position regarding the appropriateness or validity of either of these examples.

Example 1:

> "... *except* that we express no opinion concerning any effect on such excludability of subsequent action that under the terms of the [Resolution/Indenture or Loan Agreement] may be taken only upon receipt of an opinion of counsel of nationally recognized standing in the field of municipal bond law that such action will not adversely affect such excludability...."

Example 2:

> "We express no opinion regarding the excludability from gross income of interest on the Bonds for federal income tax purposes on or after the effective date on which any change contemplated by the [Resolution/Indenture or Loan Agreement] occurs or action is taken upon the approval of counsel other than ourselves."

The first example does not as much provide for an "explosion" of the opinion as simply point out that the original bond counsel does not, in the original opinion, address the consequences of any subsequent changes to the documents that can be made only with a bond opinion. In this formulation, the full original bond opinion remains in effect, and only the effect of the post-issuance action is excluded. In such a situation, only a "no adverse effect" opinion need be rendered to permit a change, and investors may rely on the "no adverse effect" opinion for the issues that it addresses, and may continue to rely on the original opinion for all other issues. *But see* Comment (**B**).

In the second example, if counsel other than original bond counsel opines on changes to the bond documents, the original bond opinion expressly no longer addresses tax exemption after the changes. Bond counsel who follow the second example may be unwilling to extend the benefit of their tax opinion to bondholders after a change because of a concern that the "no adverse effect" opinion may be inconsistent with the basis on which their original opinion was rendered. If the second example is used, counsel rendering an opinion with respect to the change may be requested or required to opine not only on the consequences of the post-issuance event but also on the tax treatment of interest on the bonds (*i.e.*, effectively replacing *in toto* the original tax opinion that has "exploded"). Even when the tax opinion "explodes," bondholders should retain the benefit of the original opinion to the extent that it has not "exploded" (*i.e.*, relating to the validity of the bonds and tax treatment of interest on the bonds as of the date of bond issuance, determined without regard to the consequences of the change on which the new counsel opined).

If bond counsel uses an express form of "exploding" opinion limitation, any accompanying disclosure document should clearly disclose that limitation and its consequences to promote understanding by both initial recipients and subsequent purchasers of the limitations of the opinion and the circumstances and manner in which it ceases to be applicable. If an opinion "explodes" after the issuance of the bonds, bondholders may have difficulty learning that the opinion may no longer be relied on with respect to some or all of the issues originally covered by the opinion. Additionally, bond purchasers after the date that the opinion "exploded" might be unaware that it is no longer in effect. *See Disclosure Roles*, at 148 and 149, for a discussion of standard delivery practices. For that reason, consideration should be given to disclosing whether a new opinion must be received as a condition to the action that terminates or limits the original bond opinion (and, if so, the requirements, if any, for the new opinion) and whether (and, if so, how and when) bondholders will be notified of the action.

d. "Qualified" and "Unqualified" Opinions

Because the vast majority of bond opinions currently are "unqualified" opinions as described in Comment (H), disclosure should be made if the bond opinion is "reasoned" or "qualified" or otherwise is not "unqualified" as discussed in this report. *See* "Other Types of Opinions" herein. In this instance, the form of opinion should be included as an exhibit to the offering document.

e. Alternative Minimum Tax

The model opinions include language addressing the federal tax treatment of interest on the bonds under the alternative minimum tax. Disclosure with respect to the alternative minimum tax treatment of interest on the bonds should be included in the disclosure document.

f. "Bank Qualified Bonds"

If the issuer has designated the bonds as "qualified tax-exempt obligations" within the meaning of Code Section 265(b)(3), appropriate disclosure of such fact and its consequences should be included in the disclosure document.

g. Risk of IRS Audit

In recent years, the IRS has instituted a vigorous program of both random and targeted audits. Any audit of particular bonds can affect their market value. From time to time the IRS has announced that it will audit bonds of a particular type, or bonds implicating the interpretation of a particular section of the Code. Practice varies, but many bond lawyers believe that disclosure of the general risk of audit is not necessary in most circumstances. The following is one example of general disclosure that may be used if disclosure of the general risk of audit is determined to be appropriate:

> "The Internal Revenue Service (the "IRS") has established an ongoing program to audit tax-exempt obligations to determine whether interest on such obligations is includible in gross income for federal income tax purposes. Bond Counsel cannot predict whether the IRS will commence an audit of the Bonds. Owners of the Bonds are advised that, if the IRS does audit the Bonds, under current IRS procedures, at least during the early stages of an audit, the IRS will treat the [name of issuer] as the taxpayer, and the owners of the Bonds may have limited rights to participate in such procedure. The commencement of an audit could adversely affect the market value and liquidity of the Bonds until the audit is concluded, regardless of the ultimate outcome."

Other issues to be considered for disclosure include whether the bonds are of a type more likely to be selected by the IRS for investigation, and whether ongoing audits are being conducted either of issues of the same type or of the same issuer.

h. Collateral Tax Consequences to Holders

If disclosure of tax consequences in addition to those covered by the bond opinion is deemed appropriate for the disclosure document, the following statement, or an expanded form thereof, may serve as appropriate disclosure:

> "Prospective purchasers of the Bonds should be aware that ownership of the Bonds may result in collateral federal income tax consequences to certain taxpayers, including, without limitation, financial institutions, property and casualty insurance companies, individual recipients of Social Security or Railroad Retirement benefits, certain S corporations with "excess net passive income," foreign corporations subject to the branch profits tax, life insurance companies and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry or have paid or incurred certain expenses allocable to the Bonds. Bond Counsel does not express any opinion regarding such collateral tax consequences. Prospective purchasers of the Bonds should consult their tax advisors regarding collateral federal income tax consequences."

i. Original Issue Discount

When bonds are sold with original issue discount, counsel should consider disclosure of this fact. The following language is one example of appropriate disclosure:

> "In the opinion of Bond Counsel, under existing law, the original issue discount in the selling price of each Bond maturing on ______, to the extent properly allocable to each owner of such Bond, is excludable from gross income for federal income tax purposes with respect to such owner. The original issue discount is the excess of the stated redemption price at maturity of such Bond over its initial offering price to the public, excluding underwriters and other intermediaries, at which price a substantial amount of the Bonds of such maturity were sold.
>
> "Under Section 1288 of the Internal Revenue Code of 1986, as amended, original issue discount on tax-exempt bonds accrues on a compound basis. The amount of original issue discount that accrues to an owner of a Bond during any accrual period generally equals (i) the issue price of such Bond plus the amount of original issue discount accrued in all prior accrual periods, multiplied by (ii) the yield to maturity of such Bond (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period), minus (iii) any interest payable on such Bond during such accrual period. The amount of original issue discount so accrued in a particular accrual period will be considered to be received ratably on each day of the accrual period, will be excludable from gross income for federal income tax purposes, and will increase the owner's tax basis in such Bond. Purchasers of any Bond at an original issue discount should consult their tax advisors regarding the determination and treatment of original issue discount for federal income tax purposes, and with respect to state and local tax consequences of owning such Bonds."

The suggested language assumes that all interest payments made on the bond are "qualified stated interest payments" as defined in Treasury Regulations Sections 1.1273-1(c)(1)(i) or 1.1275-5(e), as applicable. If interest payments are not "qualified stated interest payments," then such payments must be included in the stated redemption price at maturity, for the purpose of calculating original issue discount, and will be accrued as part of the original issue discount.

Other special circumstances might merit additional disclosure. For example, original issue discount bonds subject to mandatory sinking fund redemption may require additional disclosure. Neither the opinion nor the disclosure document typically addresses circumstances where disposition of a bond may result in capital gain or loss or the consequences of secondary market discount. Counsel may consider whether disclosures relating to such topics should be included in certain circumstances.

j. Premium

Counsel should consider disclosure of the consequences to the initial purchasers when bonds are sold at a premium in the initial offering. Although neither the bond opinion nor the disclosure document typically addresses premium in the secondary market, counsel should also consider whether such disclosure should be included in certain circumstances. The following language is one example of disclosure in either event:

> "An amount equal to the excess of the purchase price of a Bond over its stated redemption price at maturity constitutes premium on such Bond. A purchaser of a Bond must amortize any premium over such Bond's term using constant yield principles, based on the Bond's yield to maturity. As premium is amortized, the purchaser's basis in such Bond and the amount of tax-exempt interest received will be reduced by the amount of amortizable premium properly allocable to such purchaser. This will result in an increase in the gain (or decrease in the loss) to be recognized for federal income tax purposes on sale or disposition of such Bond prior to its maturity. Even though the purchaser's basis is reduced, no federal income tax deduction is allowed. Purchasers of any Bond at a premium, whether at the time of initial issuance or subsequent thereto, should consult their tax advisors with respect to the determination and treatment of premium for federal income tax purposes, and with respect to state and local tax consequences of owning such Bonds."

3. Other Disclosure

a. Prospective Legislation

Disclosure on legislation currently before a state legislature or the U.S. Congress that may affect validity, tax exemption, or market value of bonds appropriately may be included in the disclosure document. In past years, legislation has been introduced in Congress that, if enacted, would retroactively deny tax exemption to interest on bonds even though, upon issuance, all then-existing qualifications for tax exemption were met. Some bond counsel insist on disclosure of this generic risk; others disclose only when specific legislation is pending. Facts and circumstances will affect disclosure decisions on specific legislation. These facts and circumstances include the identities and status of the sponsors of the bill and its status in the legislative process.

b. Litigation

As discussed above in Comment (T) under "No-Litigation Certificate," in some circumstances bond counsel may deliver an "unqualified" opinion even if litigation is pending that challenges the validity of the bonds or some critical covenant or security pledge with respect to the bonds. Such litigation may involve the bonds being issued, or may challenge other obligations being issued under the same statutory provisions or in reliance on legal conclusions required for bond counsel's opinion. Even if bond counsel delivers an "unqualified" opinion, disclosure of the existence of such litigation and its status may be appropriate. Bond counsel may reference such litigation in the bond counsel opinion, and a description of the litigation in the section of the disclosure document discussing the bond opinion may also be appropriate. Disclosure also would be appropriate if bond counsel is relying on the opinion of other counsel regarding the outcome of such litigation, as such other opinion is an essential link in the chain of conclusions sustaining the validity of the bonds.

This discussion does not address the issues relating to disclosure of litigation that may affect the creditworthiness of the issuer or conduit borrower.

c. Potential Conflicts of Interest

The Securities and Exchange Commission has asserted that "information concerning financial and business relationships and arrangements among the parties involved in the issuance of municipal securities may be critical to any evaluation of any offering." This assertion suggests that, in the view of the Securities and Exchange Commission, in certain cases the relationship of bond counsel to other parties, or assumption by bond counsel of other roles, may be material and therefore require disclosure. *See 1994 Interpretive Release*—Primary Offering Disclosure—Areas Where Improvement is Needed—Conflicts of Interest and Other Relationships or Practices. *See also GFOA Guidelines,* Section XII.

V. OTHER TYPES OF OPINIONS

Opinions other than "unqualified" opinions were considered to be beyond the purview of prior model bond opinion reports. While preparing this report, the Committee learned that, although opinions other than "unqualified" opinions are only used very rarely, there are instances in which "qualified" or "reasoned" opinions are being rendered by bond counsel, particularly in the context of certain privately-placed or secondary-market financings. Inclusion of the following discussion of "qualified" or "reasoned" opinions, however, is not intended as a recommendation that bond counsel provide such opinions in lieu of "unqualified" opinions in any particular circumstance.

As with "unqualified" opinions, "qualified" or "reasoned" opinions express bond counsel's professional judgment regarding the legal matters being considered, but indicate a lesser degree of confidence that a court would agree with those legal conclusions. The form of qualification or degree of reasoning in a "qualified" or "reasoned" opinion will depend on the particular legal issue, the facts of the transaction, and relevant legal precedents and authority. The opinion should provide sufficient information for potential purchasers to determine whether an opinion is an "unqualified" opinion or a "qualified" or "reasoned" opinion. A potential purchaser should conclude that an opinion is "qualified" or "reasoned" if the opinion contains any discussion of conflicting cases or rulings, an analysis of legal authorities and precedents, or a phrase such as "while the matter is not free from doubt." Additionally, "reasoned" opinions frequently provide that the conclusion "should" or "would" be as set out in the opinion (rather than "will" or "is"). *See Glazer and Fitzgibbon on Legal Opinions*, at 74-79 for a general discussion of "qualified" and "reasoned" opinions. In general opinion practice, "should" and "would" opinions are viewed generally as conveying an equal degree of professional judgment regarding the judicial resolution of issues in the opinion. *See TriBar 1998 Report*, at 607.

To the extent possible, "qualified" or "reasoned" opinions should indicate counsel's level of confidence so that holders and prospective purchasers, in making an investment decision and in pricing the obligations, can evaluate the likelihood that the court will disagree with the conclusions stated by the opinion. A common phrase used in transactional tax opinions is "more likely than not." Such an opinion indicates that, in the opinion giver's professional judgment, more than a 50% likelihood exists that a court would concur with the conclusions in the opinion. See *Drafting Legal Opinion Letters, Second Edition*, by John Sterba (1992), §7.7, and Proposed Circular 230 Regulations released January 11, 2001, §10.35.

"Qualified" and "reasoned" opinions reflect a lower level of certainty in the conclusions expressed than in the case of an "unqualified" opinion. Accordingly, in addition to attaching the form of opinion to any disclosure document prepared for the issue, the opinion's limitations should be disclosed in the disclosure document. So long as "qualified" and "reasoned" opinions remain infrequent in the municipal securities marketplace, this disclosure should be conspicuous. *See* "Disclosure Matters—Disclosure Issues—Tax Issues—'Qualified' and 'Unqualified' Opinions" herein.

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Proposed Circular 230 Regulations released January 11, 2001.

BASIC PRINCIPLES OF A PUBLIC FINANCE PRACTICE

CONSTITUTIONAL/STATUTORY PRACTICE

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BASIC PRINCIPLES OF A PUBLIC FINANCE PRACTICE

Revised July 2005 by Richard L. Sigal, Partner, Hawkins Delafield & Wood LLP

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*Indicates that Hawkins Delafield & Wood LLP was either the litigation counsel or bond counsel directly or subsilentio assisting counsel in defending the constitutionality of the Act.

CONSTITUTIONAL/STATUTORY PRACTICE

1. The role of bond counsel and the validity opinion

(a) Issuance of debt securities by local governments in the 1700s and 1800s was accompanied by approval of proceedings under local law by local attorneys. As the country expanded, localities sought to entice railroads to run lines through their jurisdictions by agreeing to buy railroad stock and by issuing public debt to finance such purchases or to construct the lines sometimes even for two companies that were in direct competition. Bankruptcy by many railroads resulted in certain of those municipalities that had issued railroad bonds secured by the taxing power claiming in the court that those bonds were invalidly issued and, in several cases, the court held that they were invalid as not issued for a "public purpose" or violative of some specific state constitutional provision. Banks (who were the primary purchasers of bonds, then and until the mid-nineteen sixties) began to require as a condition to the purchase of an issue of municipal bonds that the delivery be accompanied by an opinion as to the "validity" of such public debt by their bank counsel; those counsel (including a Hawkins or a Delafield or a Longfellow) then became thoroughly conversant with municipal law; those counsel reviewed, and more times than not, sent back to municipal counsel the paperwork, in order to correct some procedural defect, thus not permitting the client/bank to buy the municipal bonds at that time. It was not long before everyone figured out that the best process would be for the municipality to retain that lawyer from the beginning of the bond authorizing procedure pursuant to state law and thus, the beginning of the bond counsel practice was born - Retained by the issuer to render an opinion for the buyer. Hawkins and others located in the major money centers of New York, Chicago and Boston soon devoted a substantial practice to this specialty.

(b) Although much attention is focused today on the technicalities of federal tax-exemption, the fundamental role of bond counsel, to approve the validity of bond issues, continues to be the main event of the bond counsel practice, on both tax-exempt and taxable public finance/municipal issues. While the solution to mistakes in tax opinions can be, and usually is, a settlement agreement by the issuer with the Internal Revenue Service, the holder of an invalid bond has little or no recourse in law or equity since the state or municipal issuer is without legal authority to pay out tax or rate payer's money. Special expertise by bond counsel in the review and interpretation of state constitutions and statutes is required to render the approving opinion and to structure the terms and security provisions of the bond. In addition, there are certain US Constitutional provisions that also need to be understood as applicable and reviewed in rendering validity opinions on municipal bonds.

2. State Constitutions

State constitutions generally are drafted as express limitations imposed by the people of the state on the power of the legislature to enact laws and of the government to act: A state constitution's financing provisions are usually not grants of power but are instead written as restrictions (debt limits; referendum requirement; faith and credit pledge requirement) on the otherwise plenary power of the people of a state exercised through the enactment of statutes. Once in a while a constitutional provision mandates a requirement or duty on the legislature wherein it then becomes the source of the power of the legislature to act. See Article 8, Section 12 of the NY Constitution as follows:

> "It shall be the duty of the legislature, subject to the provisions of this constitution, to restrict the power of taxation, assessment, borrowing money, contracting indebtedness, and loaning the credit of the counties, cities, towns and villages, so as to prevent abuses in taxation and assessment and in contracting of indebtedness by them. Nothing in this article shall be construed to prevent the legislature from further restricting the powers herein specified of any county, city, town, village or school district to contract indebtedness or to levy taxes on real estate. The legislature shall not, however, restrict the power to levy taxes on real estate for the payment of interest on or principal of indebtedness theretofore contracted."

This mandate has been particularly important in assessing the merits of certain financings for which the firm has been requested to provide and, in fact, rendered the validity opinion despite the threat of litigation. Our so-called "Billion Dollar" or "Bet the Franchise" opinion to allow the first financing to be marketed in the 1975 New York City fiscal crisis is the prime and most noteworthy example of this firm's understanding of the constitutional restraints and mandates of the New York Constitution and our confidence in, and the bond investors' respect for, that expertise. See Quirk et al. v. Municipal Assistance Corporation for the City of New York*, 41 N.Y. 2d 644 (1977) decided two years after we rendered our opinion and upheld the bonds on the same legal theory that was set forth in our office memo (upon which we based our opinion).

The same fiscal crisis in 1975 also produced perhaps the most dramatic decision ever in the State of New York and perhaps in municipal finance. The Court of Appeals held that the act mandating a moratorium on the City's requirement to pay its debt violated the full faith and credit provision of the New York Constitution. (The passage of that act by the legislature prompted the then Senior Partner, Henry E. Russell to write Governor Hugh Carey his regret that he held his license from a "banana republic".) See Flushing National Bank for itself and City Noteholders v. Municipal Assistance Corporation for the City of New York*, 40 N.Y. 2d 731 (1976).

3. State legislative acts

(a) So long as the actions are not prohibited by the state constitution (and the US Constitution), the state legislature has full power to grant power to, and impose restrictions on the Executive Branch of the State and its departments and the political subdivisions of the state.

(b) State legislative acts regarding political subdivisions (including agencies, *etc.*) are affirmative grants of power. Judge Dillon, an early member of a predecessor firm of Hawkins, Delafield & Wood, in his treatise established "Dillon's Rule": a local political entity possesses only those powers (1) granted by express legislative text, (2) necessarily or fairly implied in or incident to the powers expressly granted, and (3) those essential to the purposes of the entity. Certain states have interpreted state statutes in light of Dillon's Rule more strictly than others; they are termed "strict Dillon's Rule states".

(c) State legislative acts providing the State or a department of the State with programmatic and financing powers is usually framed as a grant of power and is, of course, subject to any State constitutional restrictions. Similarly, State legislation creating and empowering a public authority with programmatic and financing powers is subject to constitutional provisions restricting their creation. Sometimes a State department, such as the Department of Transportation, may be the beneficiary of a direct constitutional provision such as the dedication of motor vehicle taxes to pay the debt service on highway improvement bonds.

(d) An exception to state legislative power in some states is the grant of "home rule" powers in a State constitution to all or specific localities, usually subject to reservation of state power to certain specified or implied categories of statewide concern (which most times includes bond financing). Constitutional "home rule" power places the home rule entity on a parity with or superior to the state legislature in terms of legislative governance.

4. U.S. Constitutional issues

States may not act in violation of basic principles established in the US Constitution. Certain Articles and Amendments to the US Constitution are particularly applicable to municipal finance and need to be reviewed by bond counsel in light of their effect on validity of debt securities, as well as their effect on the underlying security structure of any bond transaction.

(a) *Equal protection*: The 14th Amendment precludes a state from denying to any person the equal protection of the laws. This requires that due process be adhered to. Serrano v. Priest, 557 P. 2d 929 (1976) is in colloquial terms known as the dollar per scholar case because the decision limits the amount of expenditures by certain wealthy school districts unless, in effect, there is equal spending in all districts. City of Phoenix v. Kolodziejski, 399 US 204 (1990) holds that the Equal Protection clause precludes permitting only property owners to vote in a general obligation bond referendum; first prospective ruling in public finance in that the Supreme Court explicitly held that its holding was to NOT invalidate prior referendums..

(b) *Commerce clause:* Article I, Section 8(3) of the US Constitution states that Congress has the power to regulate commerce among the states. The "dormant Commerce

Clause" interpretation of this provision is that the states are without power to take actions that impermissably burden interstate commerce. Carbone v. Town of Clarkstown, New York,* 511 U.S. 383 (1993) holds that a town cannot direct solid waste to a designated site. Very interesting body of law in which this firm filed an amicus and generally speaking believe the public interest need to provide a safe and healthy long-term solution to disposal of solid waste was inappropriately trumped by the Commerce clause, primarily resulting from certain responses of counsel in the oral argument. Suffice it to say that not all "flow control" legislation is unconstitutional and this body of law needs to be regularly reviewed and understood in our service contract practice.

(c) *Establishment of religion:* The Establishment clause precludes a state from undertaking activities that promote the establishment of religion. Hunt v. McNair, 187 S.E. 2d 645, aff'd 413 U.S. 734 (1973) is the leading Supreme Court bond case permitting bonding under certain circumstances and standards for religious schools; and Virginia College Building Authority v. Lynn, 538 S.E. 2d 682 (2000) permits bonding for a private religious university and reversing prior Virginia law. See earlier case of Habel v. Industrial Development Authority of the City of Lynchburg, 400 S.E. 2 516 (1991).

(d) *Impairment of contract:* Article I, Section 10 of the US Constitution precludes a state from taking action which impairs valid contracts entered into with the state. Patterson v. Carey*, 41 N.Y. 2d 714 (1977), U.S. Trust Co. of New York v. New Jersey et al.,* 431 U.S. 1 (1977), and Energy Reserves Group, Inc. v. Kansas Power & Light Co., 459 U.S. (1983) are three cases that address the impairment article and must be read to appreciate the contractual context in which municipal bonds are issued. As a result of this line of cases, we sometimes need to insert certain provisions in our bondholder covenant section to assure that bondholders have the legal protection afforded by this Article of the U.S. Constitution. In working with Indian nations on certain financings (which do not have the benefit of such an Article), it becomes very clear how fundamental to any security this Article is.

(e) *Interstate compact:* The Interstate Compact clause precludes states, without federal consent, from entering into agreements that have the effect of increasing state power to the detriment of federal power. The Port Authority of the States of New York and New Jersey is the primary public authority formed, after explicit Congressional approval, by compact. There is some law suggesting that Congressional approval can be implicit.

(f) *Supremacy clause:* Article VI, Section 2 of the US Constitution makes federal law the supreme law of the land. South Carolina v. Baker, 485 U.S. 505 (1988), approved the Federal requirement of registration of municipal bonds with the result that the argument that tax exemption as a sovereign power reserved to the States by the Tenth Amendment was discredited in favor of the Federal Supremacy clause. This was a very high profile case at the time but unfortunately was on a procedural matter regarding bond registration rather than on a substantive challenge on the real conflict of public interest, *i.e.*, the power of the federal government to tax the interest on municipal bonds as the power to destroy the sovereignty of the states and its municipalities.

5. Federal statutory issues

There are several Federal Statutes that are almost of the same significance in our municipal practice as the US Constitution. The following are examples:

(a) *Antitrust laws:* Are the states free to undertake any action, even though such action would be illegal under the US antitrust laws if undertaken by a private person? The current case law suggests that the "state action doctrine" immunizes any action undertaken by a state with specific legislative authorization. If a state board or agency or local government undertakes the action, the court may apply the "Midcal test" to determine if the conduct was clearly articulated by the state (such as by statute) and some courts may also require active supervision by the state. Freedom Holdings is a current 2nd circuit case in which the complaint alleges a cabal by the Attorney Generals of 48 States and the Tobacco companies in the settlement of those State claims against the Tobacco companies.

The more formal way of articulating the antitrust exemptions of the State is as discussed in the following cases: Eastern Railroad Presidents' Conference v. Noerr Motor Freight, Inc., 365 U. S. 127, 135 (1961); United Mine Workers v. Pennington, 381, U.S. 657, 670 85 S. Ct. 1585, 1593 (1965); see also Manistee Town Center v. City of Glendale, 227 F. 3d 1090, 1093, 9th Cir. (2000) (holding government entities or officials not subject to liability for activity that is protected by Noerr-Pennington immunity). Under the Noerr-Pennington doctrine, antitrust liability cannot be based upon participation by a state in the litigation process or attempts to influence the passage or enforcement of laws even if the litigation conduct or the laws so advocated would have anti-competitive impacts.

When a state exercises its legislative authority and adopts a statute that has anticompetitive impact, neither the state nor the private parties acting at the direction of the state can generally be liable for antitrust violations based thereon. See Parker v. Brown, 317 U.S. 341 63, S. Ct. 307 (1943); see also PTI, 100 F. Supp. 2d at 1196.

Following Parker, the United States Supreme Court articulated two standards for antitrust immunity: (1) the challenged restraint must be "clearly articulated and affirmatively expressed as state policy", and (2) the state must "actively supervise" the policy. Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 105 (1980). Several years later, the Court held that "when a state legislature adopts legislation, its actions constitute those of the State, and *ipso facto* are exempt from the operation of the antitrust laws". Hoover v. Ronwin, 466 U.S. 558, 567-69 (1984) (stating that "where the conduct at issue is in fact that of the state legislature or supreme court, we need not address the issues of 'clear articulation' and 'active supervision'".

(b) *Bankruptcy laws*:

Federal law. A political subdivision, public agency or instrumentality of a state can only be placed into bankruptcy on its own act and only if authorized to do so by state statute. The enforcement of the municipal bonds in the event that the issuer is allowed to be, and is validly under, the jurisdiction of the Federal Bankruptcy Act is so unprecedented and subject to the discretion of the court that our validity opinion simply expressly excludes federal bankruptcy matters. In re City of Bridgeport, 128 B.R. (1991) and in re County of Orange 183 B.R. 594 (1995) are two recent examples of bankruptcy matters in a municipal context.

There are also State laws that permit municipal reorganization or the like, the effect of which on the enforcement of the bond obligation we also exclude from our opinions. A statute to permit a municipality to be relieved of timely payment of debt does not constitute a municipal reorganization and for the most part any attempt by a State to seek to delay, stop or avoid payment of debt can be viewed (except for extreme emergency under certain cases) under the U.S. Constitution as an impairment of contract and therefore unconstitutional, meaning in effect that the Federal Bankruptcy Act which technically derives its Federal power from Article I, Section 8, of the U. S. Constitution has pretty much preempted the States from passing statutes permitting a municipality in fiscal distress to rewrite the bond contract. Recently, the Federal Bankruptcy Act was amended to clarify what constitutes state authority for a municipality to file for federal bankruptcy. Bear in mind that no State can be a bankrupt under the Federal Bankruptcy Act.

(c) *Securities Law (10 b5):* The fraud provision of the Securities Act of 1933 applies to the offering of municipal bonds. From time to time the SEC does investigate and apply sanctions to municipalities and their officials in connection with abuse in their offering documents.

6. State constitutional restrictions

(a) *Debt limits.* State constitutions generally limit the amount of "debt" of the state and localities that can be issued.

Lonegan v. State of New Jersey et al., 176 N.J. 2 (2002) provides a lengthy review of New Jersey state case law and reaffirms that only debt that is legally enforceable against the state is subject to the constitutional debt limit.

Schultz v. New York State Legislature*, 244 App. Div. 2d 126 (1998), appeal dismissed by Ct. of Appeals 92 NY 2d 818 (1998) challenged the establishment of the New York City Transitional Finance Authority and legislating that the City personal income tax belongs first to the Authority as security for its bonds. The act challenged and upheld in this case was by its explicit legislative recitals designed to circumvent NY constitutional debt limits as outmoded and to allow The City of New York to finance needed capital improvements in lieu of submitting to the voters a proposition to vote for or against an amendment to repeal or replace the debt limit provision of the NY Constitution.

(b) Referendum Requirements.

Incurrence of debt by the State, in some states and by some or all municipalities, in some states, may require the affirmative vote of the people of the state (or municipality) at a referendum, which may restrict by purpose the proposition to be voted on. In some instances, certain types of debt are prohibited by a constitutional provision so the proposition may have to include both the bond authorization and the amending section (for example, in California, deficit *bonding was expressly prohibited and general obligation state debt was subject to voter approval,* so we and other counsel for the State had to draft so as to first vote on a proposition to amend the California Constitution to permit an exception for a one-time multi-billion dollar deficit financing and second, to vote on the actual deficit bond proposition).

The Alaska constitutional provision is as follows, "no state debt shall be contracted unless authorized by law for capital improvements and ratified by a majority of the qualified voters of the state who vote on the question except in the event of invasion, natural disaster or war. (AK Const., Art IX, §8)." Suber v. Alaska State Bond Committee*, 414 P. 2d 546 (1966) is a case that permitted the State to issue bonds to pay off mortgage bank debt of private homeowners whose house and land were destroyed by earthquake under the "natural disaster" exception. Research on a state by state basis will reflect whether any one or more of judicially established doctrines (identified below) will exempt a transaction from the constitutional limitations on debt or referendum.

(c) *Special fund doctrine:* Certain states recognize that if the bonds are to be paid from a specific source of revenues (such as turnpike receipts) and not from the general taxing power of the state or locality, "debt", within constitutional and statutory meanings, is not created. Some expand this to allow use of certain receipts, which but for the statutory segregation, would be payable to the general fund. In other words, cases distinguish to permit financings where the project built with the bond issue produces the revenues and to disallow financings that use revenues generated from sources other than the project to secure the bond issued to finance that project. Scrutiny of any constitutional provision relating to general fund deposits is needed in any state that the special fund approach is being considered. Saratoga Harness Racing Association v. Agriculture and New York State Horse Breeding Development Fund, 22 N.Y. 2d 119 (1968).

(d) *Subject to appropriation:* Most states recognize that an obligation is considered debt only if a future legislature is legally bound to appropriate moneys for the obligation. If, instead, there is no enforceable obligation to appropriate for the obligation, no "debt" is incurred. The perception that the act which includes provision that the Governor *shall* certify to the legislature the amount of the deficit in a capital debt service fund and that the Legislature *shall* appropriate that amount instills, at the least, a "moral obligation" for the legislature to appropriate to make up a deficiency in a reserve debt service fund or the like has resulted, in New York State, as well as other states, in lawsuits claiming that "subject to appropriation" bonds are illegal end runs on constitutional and statutory debt limits. The theory of the investment bankers and market was best explained in one deal meeting by a banker, as follows: if the legislature "fails" to appropriate, that State's credit will "crash" so the market has confidence that that state will not allow such a result and, accordingly, the market accepts the so-called appropriation risk. Wein v. City of New York et al., 36 N.Y. 2d 610 (1975) is a case that clearly approved "subject to appropriation" debt in New York stating since the obligation of the City of New York to pay annually the Reserve Stabilization Corporation the amount of its annual debt service on its bonds is, by the express statutory provision, subject to appropriation, it is a permissible gift to the bondholders of such public benefit corporation.

Steup et al. v. Indiana Housing Finance Authority*, 402 N.E. 2d 1215 (1980) is a state housing finance agency case, which, along with others in California, Maine, South Carolina, and several other states upheld the classic moral obligation, subject to appropriation debt, utilizing the capital reserve fund to permit a year's grace time for the Governor's certification and the "permissive" legislative appropriation process.

It is also from these cases where young lawyers learn that "shall" may mean "may" in statutory construction (directory, not mandatory) and that in order to make sure "shall" means "shall", the drafter must use the word "must".

Our validity opinion covers the legal and disclosure issues, on this particular point, generally as follows: "Section 4906 of the Act (i) does not bind or obligate the State to appropriate and pay to the Authority in any year the amount duly certified to the Governor by the Director of the Authority as necessary to restore the Housing Reserve Fund to the Housing Reserve Fund Minimum Requirement, the language of such Section being permissive only, but there is no constitutional bar to the Legislature's making such appropriations for such purposes if it elects to do so, and (ii) does not constitute a loan of credit of the State or create an indebtedness on the part of the State, in violation of the provisions of Article IX, Section 14, of the Constitution of the State."

Perhaps the best example of the theory of law that supports the holding that a statutory provision stating the payment, subject to appropriation, from the general fund of a municipality to pay debt service on the bonds issued by an authority created to finance a project on behalf of the County is found in Virginia wherein that Supreme Court first ruled it was debt and then on rehearing ruled it was not.

> "Subject to appropriation" financing does not create constitutionality cognizable debt because it dos not impose any enforceable duty or liability on the County. Expectations of bondholders, County officials, or bond rating agencies do not create County "debt" any more than the expectations of the railway for [**10] continued appropriations by the state created state debt in Harrison v. Day, supra, wherein the County stated: [T]here was no constitutionally prohibited debt even though the "expectation" of these continued appropriations was an essential ingredient in the negotiations . . .This [**9] did not in any way contractually obligate the state to make these appropriations. Dykes v. Northern Virginia Transportation District Commission, et al., 411 S. E. 2d 1 (1991)

Note that debt limit and referendum cases involving the definition of "debt" will usually be the precedent for determining how to circumvent either provision. The referendum requirement and/or debt limitation clauses limiting the power of the legislature to authorize projects and project financing for essential governmental service needs is given the major credit for the statutory creation of public authorities or on behalf of entities and financing structures that have at the core what a Maine Court coined as the "chicken out" executory clause. Edgerly v. Honeywell, 377 A 2d 104 (1977) as follows:

> The cost of the equipment was to be paid in installments from moneys paid into the special revenue account only after moneys appropriated by the legislature to the users of the equipment had been paid into the account. There was specific provision that the state could return the equipment to Honeywell and be no longer liable for payments if ever the future legislatures failed to make the necessary appropriations. It is this latter provision, which one witness before the referee characterized as the **"chicken out"** provision, that we see as distinguishing this case from that presented in the *Opinion of the Justices, supra,* which caused the justices to declare that one legislature cannot obligate succeeding legislatures to make appropriations and that a contract with *obligates* the state to pay money over a period of [**11] years for the purchase of property creates a liability. We see no constitutional violation resulting from this contract.

(e) *Contingent obligation:* Some states recognize that an obligation to pay for services rendered, and only if rendered, creates a contingent obligation (enforceable either legally or on a quantum merit theory, but only in each year upon the service being rendered or the building being available for rent) that does not arise to the level of "debt" or "lending of credit" for constitutional and statutory purposes. Lease rental financings so long as the facility (or some substitute) is available for rent and service contract obligations so long as service is provided at the facility or otherwise are sometimes structured to fit within this doctrine. See Schulz v. State of New York, 198 A.D. 2d 554 (1993), leave to appeal denied 83 N.Y. 2d 756 (1993).

(f) *Public benefit corporations:* Most states allow for the establishment of public authorities known in New York as public benefit corporations by statute with power to engage in specific public activities, and issue bonds that are not backed by any obligation of the state for funding. These entities are the primary issuers of revenue bonds in this country. In the 1960's and early 1970's there were "test cases" establishing the separateness of these entities from the state and insulating their bond issues from characterization as "debt" of the state or localities. Recently in New York, we have had real litigants, such as Professor Wein and then Bob Schulz who challenged financing acts as a matter of civic duty.

> Schulz et al. v. State of New York et al.*, 84 N.Y. 2d 231 (1994). (Pothole Bonds)
>
> Schulz et al. v. State of New York et al.*, 81 N.Y. 2d 336 (1993) (LGAC Bonds)

(g) *Public purpose:* All state constitutions embody a fundamental concept that public funds should be raised and used only for a "public purpose". An extension of this doctrine is that the public purpose be the predominant (or a significant) purpose of the debt issue. This doctrine has been the subject matter of many cases and it is important to understand the precedents in the State in which bonds are being issued (those states where certain activities have been established as beyond public purpose should be reviewed). In some states, the recitals of public purpose contained in authorizing statutes suffice to permit the court to find that the "public purpose" requirement has been met.

Wilson v. Connecticut Product Development Corporation et al.*, 167 Conn. 111 (1974). This venture capital case provides the precedent for a legislative declaration of public purpose prevailing notwithstanding the remoteness of such purpose; *i.e.* the proceeds of a general obligation bond of the State loaned to a private person to develop an idea that, if successful, might result in commercial activity and employment that might be in the State.

Roan v. Conn. Indus. Bldg. Comm'n et al., 150 Conn. 333 (1963). This case defines the constitutional "exclusive public emoluments" provisions of the Connecticut Constitution as essentially a public purpose test and approves general obligation debt of the State to finance industrial development projects as long as the primary purpose is providing employment.

(h) *Lending of credit:* Primarily in response to the structuring and resulting credit and validity defaults of the municipal railroad aid bonds, states adopted constitutional provisions precluding the investment by the state and localities in private ventures through the "lending or guarantees of the general obligation credit" or gifting of public funds of the government to private enterprises. Any governmental venture that is intended for or has the effect of enhancing private interests will raise this fundamental constitutional issue. In general, a convincing overlay of public purpose may, in some states, trump this limitation; for example, low income housing may provide profits to a private developer but the overriding governmental purpose of housing the needy is served.

California Housing Finance Agency v. Elliott*, 17 Cal. 3d 575 (1976).

Maine State Housing Authority v. Depository Trust Company*, 278 A2d 699 (1971).

(i) *Full Faith and Credit:* A government entity will often use its full taxing and borrowing powers to support the payment of interest and repayment of principal. Again, some State constitutions mandate this type of security which spawns a whole body of statutory entities and financing acts expressly designed to avoid the pledge of faith and credit. "No indebtedness shall be contracted by any county, city, town, village or school district unless such county, city, town, village or school district shall have pledged its faith and credit for the payment thereof and the interest thereon" (NY Const., Art. VIII, §2).

Local Government Assistance Corporation et al. v. Sales Tax Asset Receivable Corporation et al.*, 2 N.Y. 3d 524 (2004). This is a very recent case in New York in which LGAC (composed of the three highest elected officials of the State, the Governor, the State Comptroller and the Attorney General, as counsel) sued and lost, opening, in our view, the State of New York to almost any financing structure that the State or a municipality might wish without regard to the numerous constitutional provisions provided the enabling act is carefully crafted.

(j) *Certain Other Constitutional Restrictive Provisions/Delegation of powers.* Governments may by constitution or sometimes by statute delegate certain powers to the executive branch. Also in creating a separate authority, research is required to review whether there are restrictions that are not readily apparent.

Pataki as Governor v. New York State Assembly et al., 4 N.Y. 3d 75 (2004) was a very interesting recent case that holds that New York is unique with respect to its gubernatorial budgeting powers. The New York Constitution apparently intentionally provides the Governor with paramount budget power.

Schmidt et al. v. Koch et al.* Supreme Court, 1AS Part 26, Index 13138/89 (1989) provides judicial approval of a statute that this firm drafted to permit New York City to issue water revenue bonds, notwithstanding the provisions of Article 10, section 5 of the New York Constitution. It serves as a prime example of how you must carefully research a state's constitution and then, with the history of the specific provision in mind and an understanding of how the courts, review and ruled in that State, be enabled to create a financing structure that can pass constitutional challenge.

(k) *Restrictions on special legislation:* Certain state constitutions require that financing statutes must relate to matters of general application rather than to special matters benefitting specific interests and/or require referendums on bond approval to cover one subject which is in intended to preclude logrolling of pet projects of powerful politicians and drives imaginative generic names of programs or purposes that covers multiple projects (generally, a common plan or project suffices for purposes of the one subject rule). In New York, we have many statutes that apply to municipalities with a population in excess of one million so as not to be special legislation for The City of New York.

(l) *Uniformity of taxation:* A tax that is applicable to one enterprise or person probably is invalid unless phrased as though it were generally applicable. Often, taxes that appear to be targeted are based upon a general characterization that may apply only to a few enterprises (landfill or environmentally distressed areas, for example).

(m) *Eminent Domain:* The 5th Amendment to the US Constitution provides that the government has the power to take an owner's private property for public use and upon payment of compensation to the property owner. There have been a number of court cases that address the rights of property owners. The cases clearly trend to an expansion of public use beyond actual use by the public such as for roads, Berman et al. v. Parker et al. 348 U.S. 26 (1954) allowed a taking under an urban renewal plan even where Berman's business property was not itself "blighted" and Kelo et al. v. City of New London et al. 2005 U.S. Lexis 5011 (2005) allowed a taking under a state statute declaring that the City of New London "distressed" under an economic development procedure approving a municipal economic development plan even though Kelo's home was nicely maintained.

7. State statutory restrictions

(a) *Public securities laws:* Many states have statutes which restrict the type and form of securities that can be issued. These include restrictions regarding authorization of derivatives, of public or private sale of the bonds, and official or executive approvals required and the like. For example, there may be a statutory condition precedent to comply with an environmental review statute before bond issuance; the research may result in a different answer in each State.

Sometimes, the statute is silent so Hawkins sometimes uses a variation of Dillon's Rule described earlier, as follows:

The question of whether an Act authorizing a public authority to issue bonds, also can be interpreted to authorize the execution of swaps or other deviations in the absence of express provisions in the Act, is an act by act review. Hawkins is not aware of any other reported United States federal or state court (in any state) decision that has considered the validity of interest rate swaps or similar agreements to which a municipal entity was a party, although the British House of Lords has considered the issue in a context that, in our view, is distinguishable. See Hazell v. Hammersmith and Fulham London BC and others, [1991] 2 W.L.R. 372, [1991] 1 All E.R. 545, [1992] 2 A.C. 1, [1991] R.V.R. 29, in which the House of Lords held certain swap agreements entered into by a local government authority to be *ultra vires* under British law. In addition to the different contexts, the operative language of the statute at issue in the Hammersmith decision differs from the [Act]. At issue in the Hammersmith decision was enabling legislation which provided that "a local authority shall have power to do anything (whether or not involving expenditure, borrowing or lending of money or the acquisition or disposal of any property or rights) which is calculated to facilitate, or is conducive or incidental to, the discharge of any of their functions." The House of Lords concluded, in interpreting such statutory provision, that "authorities . . . show that a power is not incidental merely because it is convenient or desirable or profitable." The statutory provision at issue in the Hammersmith decision did not contain the grant of authority to exercise *convenient* powers contained in the [Authority's Act], and thus the Hammersmith decision is not based on a consideration of a statutory grant of *convenient* powers. [The Act] does not have a liberal construction provision, however, the Authority does have the authority under [the Act] to exercise necessary, convenient or desirable powers.

(b) Environmental Review:

TriCounty Taxpayers Associa. v. Town of Queensbury, 55 NY 241 (1982) stands for the requirement of environmental statutory compliance prior to the issuance of bonds.

(c) *Usury:* Some states still have laws restricting the rate of interest that may be charged on certain debt instruments. While most such restrictions are consumer finance oriented, many also apply to governmental debt instruments. Authorizing statutes for agencies and public benefit corporations may also often contain interest rate limitations. It is important to look for limitations on interest in case of default on payment of principal and/or interest on bonds and whether that limitation can be overridden in the bond authorization.

(d) *Open meetings laws:* Most states regulate the manner in which governmental bodies can meet, adopt regulations and approve bond issues. Proper prior notice and opportunity for public comment are common elements of these statutes. In Connecticut, there is an old case holding a bond invalid when the notice for approval missed the statutory notice period by one day. Issues raised include the power of governmental bodies to meet by teleconference.

(e) *Investment of public funds:* Most states regulate the manner in which public funds (including bond proceeds) are to be invested. In certain cases, revenue bond transactions may be by a public authority pursuant to its enabling act which includes special investment powers and, therefore, may be construed as not subject to these public fund statutes. However, it is important to review these public fund investment statutes to be sure that it is not in furtherance of an explicit state constitutional provision overriding any state or authority statute or that the general statute is not by its term or date of enactment intended to override any enabling act of a public authority.

(f) *Bond Maturities:* Financing constitutional provisions or statutes often contain specific limitations on the amount of, or term of, debt that may be issued for various purposes. These may be phrased in terms of period of probable usefulness of the project being financed (respecting the term) and original principal amount or of outstanding principal amount (respecting the amount limitation) and often address whether refunding bonds (as defined in the statutes) create a need for additional statutory authority.

(g) *Public Authority Approvals:* In New York, Louisiana, and elsewhere there may be special statutes involving the establishment of, and oversight by, a State bond commission or public authorities control board or approvals by the State Treasurer or Comptroller of sales of bonds.