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December 1, 2009

Joseph T. Edmiston, Executive Director
Santa Monica Mountains Conservancy
5750 Ramirez Canyon Road
Malibu, CA 90265

RE: Use of Bond Funds for Material Legal Costs and Loans

Dear Mr. Edmiston:

In 2004, the Santa Monica Mountains Conservancy (the "SMMC") asked that we review a letter by the Office of State Audits and Evaluations of the Department of Finance (the "Department of Finance") dated March 24, 2004 (the "Management Letter") and that we provide guidance on certain findings. Among others, we commented upon Finding 7 in the Management Letter, regarding material legal costs and loans. You have recently asked us to share our advice on that particular finding again. This letter responds to your request.

Several findings of the Management Letter relate to the SMMC's use of the proceeds of general obligations bonds issued by the State under The California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002 ("Proposition 40") and the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bond Act of 2000 ("Proposition 12"). To the extent that the guidance contained in this letter relates to the permissible uses of the proceeds of general obligation bonds, it is important to understand that the Office of the Attorney General may play various roles in connection with state general obligation bonds. Clients, including the Department of Finance, often ask us to provide legal advice regarding proposed or anticipated public finance transactions. In addition, at the time the bonds are issued, the Attorney General is, in almost all cases, asked to deliver an unqualified opinion approving the transaction at closing. Generally, the opinion is expected to conclude that the bonds are valid and binding obligations of the State under state law. The standard applicable to these opinions is very high. An unqualified opinion means the Attorney General has concluded that it would be unreasonable for a court to hold to the contrary of the Attorney General's opinion; that is, it would be unreasonable for a court to conclude that the bonds are not valid and binding obligations of the State under state law. We employ this same "opinion standard" when we are asked for advice about permissible uses of bond proceeds before the bonds are issued or before the proceeds are spent.

The Attorney General, as the State's attorney, also represents the State and its agencies in almost all litigation in which the State or one of its agencies is a party, including litigation involving the State's general obligation bonds. In this regard, it is the duty of the Attorney General to diligently represent the interests of the State, and where the State's use of bond funds is at issue, the State's interest is to persuade the court that the use was permissible under the applicable bond act and the state General Obligation Bond Law (defined below).

Our analysis of Finding 7, regarding material legal costs and loans, has focused on the limitations and requirements of general and specific general obligation bond law applicable to this situation and the interface between that law and the SMMC's enabling statute. We have not considered the application of other state laws to this analysis. In addition, note that the Attorney General does not provide legal advice with respect to the requirements or implications of federal tax law.

The State Constitution and the General Obligation Bond Law

The California Constitution mandates that the Legislature cannot create debt obligations in excess of \$300,000 unless the statute creating the debt is approved by a two-thirds vote of the Legislature and is subsequently approved by a majority of the voters. The bond act must be directed toward "some single object or work to be specified" in the bond act and cannot be repealed until the principal and interest is fully paid. In addition, the Constitution mandates that bond proceeds may be applied only to the objects specified in the bond act or to the repayment of the debt created thereby.¹ Since legislators cannot create general obligation debt without voter approval, case law has held that the Legislature also cannot make substantial changes in the scheme or design that obtained voter approval of general obligation bonds, unless those changes are also subsequently approved by the voters.²

The State General Obligation Bond Law, Government Code sections 16720, *et seq.*, (the "General Obligation Bond Law") establishes the rules generally applicable to general obligation bonds. Typically, the General Obligation Bond Law is incorporated by reference into specific voter-approved bond acts. However, even where the General Obligation Bond Law is incorporated into a bond act, the bond act may contain certain provisions applicable to the specific bonds to be issued thereunder that conflict with the general provisions. In such circumstances, the will of the voters, as expressed in the specific provisions of the bond act,

¹ Cal. Const., art. XVI, § 1.

² *Peery v. City of Los Angeles* (1992) 187 Cal. 753.

prevails.³ However, the principles of statutory construction required that statutes be harmonized, if possible.⁴

Government Code section 16727 establishes the general rule and limits the use of bond proceeds to pay for the costs of constructing or acquiring capital assets. Government Code section 16727, subdivision (a), defines "capital assets" as follows:

"Capital assets" mean tangible physical property with an expected useful life of 15 years or more. "Capital assets" also means tangible physical property with an expected useful life of 10 to 15 years, but these costs may not exceed 10 percent of the bond proceeds net of all issuance costs. "Capital assets" include major maintenance, reconstruction, demolition for purposes of reconstruction of facilities, and retrofitting work that is ordinarily done no more often than once every 5 to 15 years or expenditures that continue or enhance the useful life of the capital asset. "Capital assets" also include equipment with an expected useful life of two years or more. Costs allowable under this section include costs incidentally but directly related to construction or acquisition, including, but not limited to, planning, engineering, construction management, architectural, and other design work, environmental impact reports and assessments, required mitigation expenses, appraisals, legal expenses, site acquisitions, and necessary easements.

Section 16727, subdivision (b), provides that any grants or loans of bond proceeds also must be used for the costs of construction or acquisition of capital assets. Bond proceeds may also be used to pay the costs of a state agency for administering the grant or loan program.

Like other aspects of the General Obligation Bond Law, the limitation on the use of bond proceeds will not control where the voters have approved other uses of proceeds. For example, where a bond act explicitly permits expenditure of bond proceeds for costs that would not be considered capital asset acquisition or construction costs or costs incidentally but directly related thereto, the bond act will prevail over the requirements of the General Obligation Bond Law and Government Code section 16727. However, where the permitted uses are stated in general terms

³ Gov. Code, § 16723.

⁴ "Thus there is a presumption against repeals by implication; they will occur only where the two acts are so inconsistent that there is no possibility of concurrent operation, or where the later provision gives undebatable evidence of an intent to supersede the earlier; the courts are bound to maintain the integrity of both statutes if they may stand together. [citations]." (*People v. Bustamante* (1997) 57 Cal.App.4th 693, 699).

in the bond act (such that non-capital asset expenditures are not explicitly authorized), compliance with Section 16727 is required.

Proposition 40

Proposition 40 incorporates the provision of the General Obligation Bond Law,⁵ including Government Code section 16727 set forth above, and adds the following sections to the Public Resources Code applicable to the appropriation of bond proceeds to the SMMC:

5096.610 The proceeds of bonds issued and sold pursuant to this chapter shall be deposited in the . . . [f]und [T]he money in the fund shall be available for appropriation by the Legislature, in the manner set forth in this chapter, *for acquisition and development projects*, in accordance with the following schedule:

. . .
(c) The sum of one billion two hundred seventy-five million dollars (\$1,275,000,000) *for land, air, and water conservation programs, including acquisition for those purposes*. . . .

5096.650 The one billion two hundred seventy-five million dollars (\$1,275,000,000) allocated pursuant to subdivision (c) of Section 5096.610 shall be available *for the acquisition and development of land, air, and water resources* in accordance with the following schedule:

. . .
(b) The sum of four hundred forty-five million dollars (\$445,000,000) to the conservancies in accordance with the particular provisions of the statute creating each conservancy *for the acquisition, development, rehabilitation, restoration, and protection of land and water resources; for grants and state administrative costs*; and in accordance with the following schedule:

. . .
(3) To the Santa Monica Mountains Conservancy
\$40,000,000. (Emphasis added.)

“Acquisition” is defined to mean “obtaining the fee title or a lesser interest in real property, including specifically, a conservation easement or development rights.”⁶

⁵ Pub. Resources Code, § 5096.666.

⁶ Pub. Resources Code, § 5096.605, subd. (a).

"Development" is defined to include, without limitation, "improvement, rehabilitation, restoration, enhancement, preservation, protection, and interpretation."⁷ "Preservation" is defined to mean "identification, evaluation, recordation, documentation, interpretation, protection, rehabilitation, restoration, stabilization, development, and reconstruction, or any combination of those activities."⁸

We conclude that, in addition to other permissible uses that are not the subject of this letter, Proposition 40 bond proceeds may be used to pay costs that are incidentally but directly related to the acquisition, development, rehabilitation, restoration or protection of a capital asset that is a land or water resource. These costs include, but are not limited to, "planning, engineering, construction management, architectural, and other design work, environmental impact reports and assessments, required mitigation expenses, appraisals, *legal expenses*, site acquisitions, and necessary easements." (Gov. Code, § 16727, subd. (a), emphasis added.)

Proposition 12

Proposition 12 also incorporates the provisions of the General Obligation Bond Law.⁹ In addition, Proposition 12 added the following sections to the Public Resources Code that are specifically applicable to the appropriation of bond funds to the SMMC:

Public Resources Code section 5096.310 provides that "the proceeds of bonds issued and sold . . . shall be deposited in the [f]und" and,

money in the fund shall be available for appropriation by the Legislature, in the manner set forth in this chapter, *only for parks and resources improvement*, in accordance with the following schedule:

(p) The sum of thirty-five million dollars (\$35,000,000) to the Santa Monica Mountains Conservancy, in accordance with Section 5096.353.

Section 5096.353 provides as follows:

Funds allocated pursuant to subdivision (p) of Section 5096.310 shall be available to the Santa Monica Mountains Conservancy *for capital outlay and grants for the acquisition from a willing seller*,

⁷ Pub. Resources Code, § 5096.605, subd. (c).

⁸ Pub. Resources Code, § 5096.605, subd. (j).

⁹ Pub. Resources Code, § 5096.361.

enhancement, and restoration of natural lands, improvement of public recreation facilities, and for grants to local agencies and nonprofit organizations to increase access to parks and recreational opportunities for underserved urban communities, in accordance with the following schedule:

Thirty-five million dollars (\$35,000,000) *to acquire, improve, or restore park, wildlife, or natural areas, including areas near or adjacent to units of the state park system wherever such units may be situated within a local jurisdiction within the Santa Monica Mountains Zone or Rim of the Valley Trail Corridor. (Emphasis added.)*

“Acquisition” is defined by Proposition 12 to mean the “acquisition from a willing seller of a fee interest or any other interest, including easements and development rights, in real property from a willing seller.”¹⁰ None of the other operative terms are defined.

We conclude that, in addition to other permissible uses that are not the subject of this letter, Proposition 12 bond proceeds may be used to pay costs that are incidentally but directly related to the acquisition, development, rehabilitation, restoration or protection of a capital asset that is a park, wildlife, or natural area. As with Proposition 40, these costs include, but are not limited to, “planning, engineering, construction management, architectural, and other design work, environmental impact reports and assessments, required mitigation expenses, appraisals, *legal expenses*, site acquisitions, and necessary easements.” (Gov. Code, § 16727, subd. (a), *emphasis added.*)

Finding 7 – Material Legal Costs and Loans

In Finding 7 of the Management Letter, the Department of Finance raises concerns regarding the charging by the Mountains Recreation and Conservation Authority (“MRCA”)¹¹ of \$698,896 in legal costs and a \$500,000 loan to pay a judgment over a period of two fiscal years. The Department of Finance notes that some of the legal costs were incurred before the passage of the bond acts, the amounts seem high in comparison to other agencies and grantees, and they appear to be a more for “ongoing litigation than the nominal legal services associated with land acquisitions.” The letter states:

We recognize that many of the Conservancy’s and Authority’s legal issues are complex and interrelated with the acquisition of

¹⁰ Pub. Resources Code, § 5096.308, subd. (a).

¹¹ The MRCA is a joint powers authority formed by the SMMC, the Rancho Simi Park and Recreation District, and the Conejo Park and Recreation District.

bond-funded properties, while some cases' relationship to bond projects may be tenuous. An Assessment of the merits of these cases and whether the associated legal fees (and any loans) should be charged to bond funds is beyond the scope of our review ... *The Resources Agency should request its legal counsel to determine whether bond funds can be used for litigation related loans and pre-bond act legal costs, and advise the Conservancy accordingly.* (Emphasis added.)

As stated above, under the General Obligation Bond Law, legal expenses are a permissible use of bond proceeds if they are reasonable and incidentally but directly related to the construction or acquisition of a capital asset — land or water resources, in the case of Proposition 40, and park, wildlife or natural areas, in the case of Proposition 12.

Tucker Land Company v. MRCA Legal Fees

It appears that the \$149,000 in legal fees charged against the bond funds in connection with the Tucker Land Company legal proceedings were incurred by the MRCA in an attempt to acquire, and then retain, title to the Eastport Property/Westridge Canyon Back Wilderness Park. It also appears that the Westridge Canyon Back Park is both a natural land resource for purposes of Proposition 40 and a park, wildlife and natural area for purposes of Proposition 12. Inasmuch as the proceedings involved a legal battle over title to the park, and the MRCA's efforts to obtain, and then retain, such title, these legal fees are incidentally but directly related to the acquisition of a capital asset and properly chargeable against bond funds. The fact that the lawsuit, the MRCA's first efforts to obtain title, and some of the legal costs pre-dated the passage of Propositions 40 and 12, does not trouble us given the on-going nature of the dispute — a dispute that commenced before, but ended after, passage of the bonds. Had the property been acquired and all disputes regarding title been resolved prior to passage of the bonds, we might feel differently. We are in no position to comment on the reasonableness of the amount of the legal expenses incurred by the MRCA in connection with its efforts to obtain and retain title to the property.

Tucker Loan

This involves a \$500,000 loan of bond proceeds by the SMMC to the MRCA in order to finance a court-ordered payment necessary to retain title to the Eastport Property/Westridge Canyon Back Wilderness Park. This represents a permissible capital asset acquisition cost under both Proposition 40 and 12.

City of Malibu v. SMMC and MRCA

The Department of Finance audit materials state the following:

Ms. Collins stated that the Streisand Center is now known as Ramirez Canyon. The property is owned by SMMC. MRCA operated the property. In order to operate the Ramirez Canyon property as a park, the Coastal Commission required SMMC/MRCA to obtain a Coastal permit. Initially, MRCA hired the law firm to advise on compliance with the Coastal Act. MRCA and the Coastal Commission agreed on several improvements to the property, including sewage systems and roads. MRCA also needed to get permits from Malibu to make the improvements. The City of Malibu sued the MRCA, SMMC, and the Coastal Commission, claiming that events being held at Ramirez Canyon violated the Coastal Act. The property improvements have been made. The suit over issuance of the Coastal permit is still pending.

The SMMC's counsel's letter (Exhibit 21 to the SMMC's response to the Management Letter) describes this matter as follows:

The City of Malibu sued the Conservancy and MRCA to stop public access to Ramirez Canyon Park. The first case was filed while the Conservancy's permit application to the California Coastal Commission was pending. The City sued again when the permit was issued. The improvements as required by the coastal permit were made with bond funds. The improvements to this state owned asset included improvements for an outreach program for disabled youths and adults, and seniors.

Department of Finance's concern appears to be with \$181,000 in legal expenses relating to Ramirez Canyon that were charged against Proposition 40 and 12 bond funds. It appears that some of those legal fees were for advice regarding the SMMC's use of Ramirez Canyon in compliance with the Coastal Act, and others were incurred in defending one or two lawsuits filed by the City of Malibu to either enjoin certain events being held on the property as violative of the Coastal Act or to prevent public access to the property, or both.

If the legal expenses were incidentally but directly related to the acquisition, development, rehabilitation, restoration or protection of a land or water resource, in the case of Proposition 40 funds, or a park, wildlife or natural area, in the case of Proposition 12, the legal expenses could permissibly be charged against the bond proceeds. There appears to be no question that Ramirez Canyon is a natural land resource and a park, wildlife or natural area. We believe that legal expenses incurred to ensure that the State's ownership and use of this property

was in compliance with the Coastal Act are costs incidentally but directly related to the protection of a State natural land resource. In addition, we believe the legislative findings and the voter materials relating to both Propositions 40 and 12 evidence an intent to acquire, develop and preserve natural resources and park, wildlife and natural areas *for the benefit of the public*, such that legal fees incurred in challenging the City's attempts to stop public access to this area are also permitted expenditures. We are in receipt of a May 14, 2004 letter addressed to Assemblymember Paul Koretz from Mindi Sheps on behalf of the Ramirez Canyon Preservation Fund, which refers to the SMMC conducting "commercial" events at Ramirez Canyon Park. We have not been provided with any details concerning this matter and the advice in this letter assumes that the subject legal expenses have not been used to defend a commercial, profit-making use of the property.

The fact that litigation over the permit and compliance with the Coastal Act was commenced prior to passage of the bonds does not trouble us in light of the fact that the litigation is still pending, and the litigation is part of the State's overall efforts to maintain compliance with the Coastal Act and public access to Ramirez Canyon. We are in no position to comment on the reasonableness of the amount of the legal expenses incurred by the MRCA in connection with its efforts.

BADTAX v. SMMC and MRCA

The letter of counsel to the SMMC, Exhibit 21 to the SMMC's response to the Management Letter, describes this lawsuit as "a validation action filed to set aside ... two assessment districts." According to the Management Letter and audit materials, legal fees in the amount of \$23,000 were charged against Proposition 40 bond proceeds.

Under Proposition 40, these legal fees were a permissible charge against bond proceeds if the legal expenses were incidentally but directly related to the acquisition, development, rehabilitation, restoration or protection of a capital asset that is a land or water resource. If the benefit assessment districts were formed for the purpose of acquiring, improving or restoring a land or water resource and the other purposes of the benefit assessment districts are consistent with Proposition 40,¹² then efforts to defend the existence of the benefit assessment districts would be costs directly related to such acquisition, improvement or restoration, and therefore permissibly financed with Proposition 40 bond proceeds.

¹² If the benefit assessment districts have more or other functions than functions that further the purpose of Proposition 40, then all of the legal costs in defending the existence of the benefit assessment districts should not be charged against Proposition 40, but should be apportioned.

Joseph T. Edmiston, Executive Director
Santa Monica Mountains Conservancy
December 1, 2009
Page 10

We hope that you will find this letter responsive to your request. Please do not hesitate to contact us with questions you may have or if we can be of further assistance.

Sincerely,

A handwritten signature in black ink, appearing to read 'Christina Bull Arndt', with a large, stylized initial 'C'.

CHRISTINA BULL ARNDT
Supervising Deputy Attorney General

For EDMUND G. BROWN JR.
Attorney General