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## Chapter 6: Curing Bond Errors and Saving Taxpayers Money

*Philip Lee*

### *Code Section Affected*

SB 141 (Committee on Local Government); 2007 STAT. Ch. 6 (*Effective April 24, 2007*).

### I. INTRODUCTION

Imagine being a private investor and deciding to invest fifteen million dollars in reliable California state bonds.<sup>1</sup> State Treasurer Bill Lockyer issues you the bonds with a maturity date of twenty years. The twenty years pass, and you come to redeem the bonds, which are now worth twenty million dollars. A new State Treasurer now holds office and tells you that he cannot redeem the bonds. Unbeknownst to you, at the time the bonds were printed, a printing mishap caused the bonds to read “State of Californie Bond.” Although a minor error, the spelling mishap has unfortunately invalidated your bond. The State Treasurer cannot honor bonds that the “State of Californie” issued, and you lose your initial investment of fifteen million dollars.

Although the holder of the public bond in the prior hypothetical scenario may have a legal remedy in quasi-contract,<sup>2</sup> a more efficient and appropriate remedy lies in legislative validation.<sup>3</sup> Chapter 6 is an example of legislative validation to guard against minor errors that threaten bonds, boundary changes, and other official acts.<sup>4</sup>

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1. This hypothetical was created based on a conversation with Peter Detwiler. Interview with Peter Detwiler, Staff Dir., S. Local Gov’t Comm., in Sacramento, Cal. (May 22, 2007) [hereinafter Detwiler Interview] (notes on file with the *McGeorge Law Review*); see also 2007 Cal. Stat. ch. 6, § 2(b) (“‘Bonds’ means all instruments evidencing an indebtedness of a public body incurred or to be incurred for any public purpose . . .”).

2. See Frank E. Horack, Jr. & C. Ben Dutton, *Statutory Validation of Public Bonds*, 7 U. CHI. L. REV. 281, 281 n.1 (1940) (“Common among the judicial remedies is recovery in quasi-contract.”).

3. See *id.* at 281 n.2 (“The principal advantages are a non-litigious settlement of the controversy and consequent savings in court costs and attorney’s fees; the removal of defects before controversy arises; formal recognition of the claim of bondholders; and a legislative direction to the municipality to make good its obligations.”).

4. See Letter from Casey Kaneko, Executive Dir., Urban Counties Caucus, to Governor Arnold Schwarzenegger, Cal. State Governor (Apr. 16, 2007) [hereinafter Kaneko Letter] (on file with the *McGeorge Law Review*) (“The validating acts increase the comfort level of persons who are interested in purchasing local bonds, because they guard against bond issues being invalidated due to minor oversights or mistakes.”); SENATE FLOOR, COMMITTEE ANALYSIS OF SB 141, at 2 (Mar. 8, 2007).

## II. LEGAL BACKGROUND

Since the mid-1920s, the California Legislature has regularly “passed separate validating acts for different types of bonds, several classes of special districts, and various local boundary changes.”<sup>5</sup> In 1939, starting with Assembly Bill 2842, the practice evolved into passing annual comprehensive Validating Acts.<sup>6</sup> “The current custom and practice is to pass three Validating Acts [a year] that retroactively<sup>7</sup> cure [any] public officials’ mistakes.”<sup>8</sup> The first two Validating Acts contain urgency clauses,<sup>9</sup> so that they take effect immediately when the bill is chaptered and retroactively cure any technical errors made from the beginning of the year until the chaptering of the bill.<sup>10</sup> The Third Validating Act takes effect January 1 of the following year and covers the period between the Second Validating Act and the end of the year.<sup>11</sup>

## III. CHAPTER 6

Chapter 6 enacted the First Validating Act of 2007, which provides legislative authorization<sup>12</sup> to cure any technical errors or omissions made by public officials that “might otherwise invalidate boundary changes or bond issues.”<sup>13</sup> Chapter 6 cures any “typographical, grammatical, and procedural errors” made by a public official, but does not forgive any “fraud, corruption, or unconstitutional acts” committed by the official.<sup>14</sup>

Additionally, Chapter 6 validates the “organization, boundaries, acts, proceedings, and bonds” of public bodies.<sup>15</sup> “Public body” is defined as “the state

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5. SENATE FLOOR, COMMITTEE ANALYSIS OF SB 141, at 2 (Mar. 8, 2007).

6. *Id.*

7. See 16B AM. JUR. 2D *Constitutional Law* § 690 (1998) (“Legislation is considered retroactive if its application determines the legal significance of acts or events that occurred prior to the statute’s effective date.”).

8. SENATE FLOOR, COMMITTEE ANALYSIS OF SB 141, at 2 (Mar. 8, 2007); see also *The Annual Validating Acts: Frequently Asked Questions* (Jan. 5, 2007) [hereinafter *Annual Validating Acts*] (on file with the *McGeorge Law Review*) (“The Legislature could pass only one Validating Act a year, but public officials would need to wait to issue their bonds until bond counsels could issue solid legal opinions. Conversely, the Legislature could pass one Validating Act a month, but that seems excessive.”).

9. See CAL. CONST. art. IV, § 8(c)-(d) (explaining that ordinary bills go into effect the January 1 following their enactment, whereas urgency statutes go into effect immediately upon their enactment).

10. See SENATE FLOOR, COMMITTEE ANALYSIS OF SB 141, at 3 (Mar. 8, 2007) (stating that the Second Validating Act reaches Governor Schwarzenegger in August, validating any mistakes made after the First Validating Act).

11. *Id.*

12. See *Miller v. McKenna*, 23 Cal. 2d 774, 781-82, 147 P.2d 531, 535 (1944) (“The Legislature may cure irregularities or omissions to comply with provisions of a statute which could have been omitted in the first instance.”).

13. SENATE FLOOR, COMMITTEE ANALYSIS OF SB 141, at 1 (Mar. 8, 2007).

14. *Id.* at 2.

15. *Id.* at 1.

and all departments, agencies, boards, commissions, and authorities of the state.”<sup>16</sup> Finally, Chapter 6 requires that any lawsuit challenging an alleged defect of a public body, bond, or boundary, if not already barred by an existing statute of limitations, be commenced within six months of the act; otherwise, the bond or boundary is considered valid and uncontestable.<sup>17</sup>

#### IV. ANALYSIS OF CHAPTER 6

Chapter 6 is vital to the operation and maintenance of the state and local governments.<sup>18</sup> The Validating Acts are passed each year to remedy “and validate numerous technical, non-controversial actions taken by local governments” and are necessary “for both legal and financial reasons.”<sup>19</sup> Additionally, Chapter 6 “is important for protecting taxpayers and investors, among others, against minor technical errors in the issuance of local agency bonds.”<sup>20</sup> Without this protection, public agencies would have to resort to legal action<sup>21</sup> every time official documents contained a slight error.<sup>22</sup>

Chapter 6 cures minor mistakes or oversights made by an official or staff member that occur during the daily operations of local government business.<sup>23</sup> Furthermore, Chapter 6 protects the integrity of state and local bonds<sup>24</sup> and “boost[s] the stability” of those bonds.<sup>25</sup> Banks, pension funds, and other investors are reluctant to purchase public agency bonds without assurances that they are sound investments.<sup>26</sup> “Investors rely on legal opinions from bond counsels to assure the bonds’ credit worthiness.”<sup>27</sup> Since Chapter 6 gives

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16. 2007 Cal. Stat. ch. 6, § 2(a).

17. *Id.* § 8.

18. See Letter from Michael F. Dillon, Cal. Ass’n of Sanitation Agencies, to Governor Arnold Schwarzenegger, Cal. State Governor (Apr. 17, 2007) (on file with the *McGeorge Law Review*) (stating the importance of the bill to the operation of local governments).

19. Letter from Ralph A. Heim, Pub. Policy Advocates LLC, to Governor Arnold Schwarzenegger, Cal. State Governor (Apr. 17, 2007) (on file with the *McGeorge Law Review*); Kaneko Letter, *supra* note 4.

20. Letter from Bill Lockyer, Cal. State Treasurer, to Governor Arnold Schwarzenegger, Cal. State Governor (Apr. 19, 2007) (on file with the *McGeorge Law Review*).

21. See CAL. CIV. PROC. CODE § 860 (West 1980) (explaining that a public official may have to file a “validation action” which is a proceeding in rem to declare the validity of a local government decision); see also Detwiler Interview, *supra* note 1 (stating that if bond counsels could not rely on the Validating Acts, they would have to take each bond to court to declare its validity, thereby clogging the court docket).

22. See Kaneko Letter, *supra* note 4 (“[L]ocal agencies would have to pay more to borrow money and they would be subject to legal action if official documents contained even slight errors.”).

23. See *id.* (“The acts cure minor mistakes that county staff might make in processing normal local government business.”).

24. See SENATE FLOOR, COMMITTEE ANALYSIS OF SB 141, at 2 (Mar. 8, 2007) (“[A] minor error might undermine the legal integrity of a public agency’s bond.”).

25. Letter from Leslie McFadden, Legislative Advocate, County of Sacramento, to Governor Arnold Schwarzenegger, Cal. State Governor (Apr. 13, 2007) (on file with the *McGeorge Law Review*).

26. SENATE FLOOR, COMMITTEE ANALYSIS OF SB 141, at 2 (Mar. 8, 2007).

27. *Id.*

legislative authority to cure technical errors, those affected bonds will be “clean bonds.”<sup>28</sup>

Financially, a “clean bond” gives bond counsels confidence to issue “[s]trong legal opinions,” which results in “higher credit ratings for state and local bonds.”<sup>29</sup> Higher credit ratings result in lower borrowing costs and interest rates for state and local governments.<sup>30</sup> Lower borrowing costs result in lower taxes for taxpayers.<sup>31</sup>

Furthermore, whenever an election is needed for the issuance of a bond for any public purpose, Chapter 6 declares that the bonds are “legal, valid, and binding obligations of the public body.”<sup>32</sup> The Supreme Court of California has “held that the Legislature may authorize the issuance of municipal bonds approved by the voters, even though the purpose of the proposed indebtedness was unauthorized at the time of election.”<sup>33</sup>

In *City of Fairfield v. Hutcheon*, after voters approved municipal bonds for the purpose of improving the water works and water system, the city clerk refused to countersign and issue the approved bonds because the “repair of the water and sewer system [was] not a proper purpose for [the] bonded indebtedness.”<sup>34</sup> The Supreme Court of California stated the Validating Act “was intended to supply the legislative authorization necessary to validate the proceedings heretofore taken.”<sup>35</sup> Since the Legislature could have provided a bond for the repair of sewer and water systems in the law,<sup>36</sup> the Act was authorized to validate the bonds, even if they were previously approved for an unauthorized purpose.<sup>37</sup>

Finally, Chapter 6 “confirm[s], validate[s], and declare[s]” the boundaries of public bodies.<sup>38</sup> Local governments levying taxes for the repayment of bonds can only do so within its boundaries.<sup>39</sup> Chapter 6 gives assurance to bondholders that a government will honor its repayment by confirming public agencies’ boundaries, thereby eliminating any challenge to the validity of when governments can levy taxes.<sup>40</sup>

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28. See Detwiler Interview, *supra* note 1 (defining “clean bond” as “a legally valid instrument”).

29. SENATE FLOOR, COMMITTEE ANALYSIS OF SB 141, at 2 (Mar. 8, 2007).

30. See *id.* (“Higher credit ratings allow state and local officials to pay lower interest rates to private investors.”).

31. *Id.*

32. 2007 Cal. Stat. ch. 6, § 6(b).

33. *City of Fairfield v. Hutcheon*, 33 Cal. 2d 475, 477, 202 P.2d 745, 746 (1949).

34. *Id.* at 476-77, 202 P.2d. at 745-46.

35. *Id.* at 479, 202 P.2d at 747.

36. See *id.* (“There can be no doubt that the Legislature could have provided in the law under which the proceedings were taken that indebtedness could be incurred for the repair of sewer and water systems.”).

37. *Id.*

38. 2007 Cal. Stat. ch. 6 § 4.

39. Annual Validating Acts, *supra* note 8.

40. *Id.*; see also *Rock Creek Water Dist. v. County of Calaveras*, 133 Cal. App. 2d 141, 146-47, 283 P.2d 740, 744 (3d Dist. 1955) (holding that the Validating Act of 1949 confirmed the inclusion of a water

V. CONCLUSION

Recently, California voters approved the sale of more than \$65 billion worth of bonds to help build and develop schools, roads, and other important public works.<sup>41</sup> With the advent of the website [www.BuyCaliforniaBonds.com](http://www.BuyCaliforniaBonds.com) and a massive advertising campaign, State Treasurer Bill Lockyer sold \$690 million worth of the state's bonds in a two-day span.<sup>42</sup> With such a large investment in California bonds, Chapter 6 assures investors and lending institutions that the bonds are good credit risks by providing legislative protection against technical errors.<sup>43</sup> Chapter 6 allows bond counsels to write strong legal opinions on California bonds, which result in higher credit scores.<sup>44</sup> Higher credit scores allow the state and local governments to pay lower interest rates and lower borrowing costs.<sup>45</sup> "A minimal reduction in the interest rate that we pay can save taxpayers millions in borrowing costs over the life of bonds."<sup>46</sup>

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district's property within the boundaries of the district).

41. Bill Lockyer, Buy California Bonds, <http://www.buycaliforniabonds.com> (last visited Dec. 29, 2007) (on file with the *McGeorge Law Review*).

42. Shane Goldmacher, *Lockyer's Bond Sale Lowers Borrowing Rate for State*, SACRAMENTO BEE, June 20, 2007, at Capitol Alert, <http://www.sacbee.com/770/story/232566.html> (on file with the *McGeorge Law Review*).

43. SENATE FLOOR, COMMITTEE ANALYSIS OF SB 141, at 2 (Mar. 8, 2007).

44. *Id.*

45. *Id.*

46. Goldmacher, *supra* note 42 (quoting Tom Dresslar, Bill Lockyer Spokesperson).