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California AG's Opinion Targets School Bond Practices.

PHOENIX – School and community college districts violate California law if they hire outside firms to campaign for bond ballot measures or purposely incentivize municipal finance professionals to advocate for passage of a bond measure, the state's attorney general said in a formal legal opinion.

Attorney General Kamala Harris released the opinion Tuesday in response to a request from Treasurer John Chiang.

California law prohibits using public funds to influence the outcome of an election, including campaigning for the passage of a bond measure. Voter-approved bonds backed by property taxes are the primary method of new school construction in the state, and Chiang sought a clarification on whether some common industry practices might be violating the law.

"A practice has developed within the municipal financing industry whereby investment bankers, financial consultants, and bond attorneys offer to contract with a school district to provide the pre-election services that the district seeks," the opinion said. "Under such an arrangement, the firm agrees to provide the pre-election services at no, or reduced, charge to the district in exchange for the district's promise to select the firm as its contractor to provide postelection services, if the bonds are approved by the voters. Naturally, it is within the firm's financial interest to be awarded the contract to provide post-election bond services."

Such California attorney general's opinions are advisory, and not legally binding on courts, but are generally considered authoritative by the officers and agencies who have requested them and given respect by judges.

Robert Doty, a lawyer and former financial advisor who now runs his own litigation consulting firm AGFS in Annapolis, Md., said the opinion is a significant development.

"This is a very important analysis for finance," Doty said. "It is not a general attempt to say that contributions are good or bad, except when they are tied to getting business."

A previous Bond Buyer investigation found a nearly perfect correlation between broker-dealer contributions to California school bond efforts in 2010 and their underwriting of subsequent bond sales, and financial advisors have similarly been accused of using "pay-to-play" tactics.

Former California Treasurer Bill Lockyer questioned the legality of the practices, and in 2013 twelve dealer firms asked the Municipal Securities Rulemaking Board to adopt further restrictions on bond ballot contributions by broker-dealers, which they are required to disclose to the board.

Harris' opinion points to a 1976 California Supreme Court case, Stanson v. Mott, in which the court ruled that public money could be used only to provide "a fair presentation of relevant information" related to a bond question. Chiang's request covered several questions, which the opinion dealt with in turn.

First, Harris concluded, school districts violate the law if they hire a firm for services that could be

construed as campaigning for the bond measure. Second, they also violate the law if they receive services from a firm in return for bond business when the campaign is successful if the district "enters into the agreement for the sole or partial purpose of inducing the firm to contribute to the bond-election campaign" or when "the firm's fee for its post-election bond-sale services is inflated to account for its campaign contributions and the district fails to take reasonable steps to ensure the fee was not inflated."

The opinion notes that districts may legally select an underwriter beforehand and essentially guarantee them the business if the campaign is successful, but the motivation of the district would determine the legality.

"In the absence of evidence to the contrary, of course, it is to be assumed that a district's actions are proper," the opinion said. "We therefore would not conclude that the existence of a contingent-compensation contract, standing alone, violates the law."

The attorney general also concluded that a district runs afoul of the law if it reimburses a municipal finance firm for providing the pre-election services as an itemized component of the fee that the district pays to the firm in connection with the bond sale, as well as if it uses bond proceeds to reimburse the firm.

Finally, Harris' office found, an entity that provides campaign services to a bond measure campaign in exchange for an exclusive agreement with the district to sell the bonds incurs an obligation to report the cost of such services as a contribution to the bond measure campaign in accordance with state and local campaign disclosure laws.

Lori Raineri, president of independent financial advisory firm Government Financial Strategies in Sacramento, said she was pleased by the opinion and that the attorney general deserved a lot of credit for taking an "important step." Raineri said there are some subtleties and loopholes that will likely to continue being exploited despite the opinion, but that many of the most blatant conflicts of interest have stopped due to increased focus on this issue in recent years. She said she will show the opinion to prospective clients so they are fully informed about the law.

THE BOND BUYER

BY KYLE GLAZIER

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