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Ms. Andrea Hoch  
Legal Affairs Secretary  
State Capitol, First Floor  
Sacramento, CA 95814 E-15

RE: Proposed Financing and Securitization of Beverage Container Recycling Fund Revenue

Dear Ms. Hoch:

You have asked us whether, assuming the Attorney General was acting as counsel to a transaction to issue bonds and securitize the revenues of the Beverage Container Recycling Fund as proposed in an Assembly budget plan, the Attorney General could give an unqualified opinion that the transaction complied with Proposition 58. In this letter, we have outlined the provisions of the proposed bond issuance and securitization as we understand them, and then analyzed how a court may apply Proposition 58 to the proposed transaction. We conclude that a court could reasonably determine that the proposed transaction violates Proposition 58. Accordingly, we could not give an unqualified opinion approving the issuance of bonds based on this transaction.

Please note that this letter does not include the detailed analysis that supports our conclusions, but instead provides summary conclusions regarding the application of Proposition 58 to the proposed transaction. And at your request, we have confined our inquiry to the validity of the proposed transaction under Proposition 58 and have not addressed herein other legal issues raised by the transaction.

### *The Proposed Securitization*

As part of a budget plan for 2010-11, the Assembly Speaker has proposed to securitize the future revenue stream from regulatory fees paid into a state special fund (the Beverage Container Recycling Fund), currently used for various state recycling programs. The proposal is modeled on prior legislation authorizing the securitization of the tobacco and tribal gaming bonds.<sup>1</sup> The future revenue stream would be sold to a newly created special purpose trust which

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<sup>1</sup> The tribal gaming bonds were challenged in litigation on multiple grounds including allegedly violating Proposition 58. The litigation was resolved by the appellate court based upon the statute of limitations, and the court did not reach or resolve the merits of the Proposition 58 challenge.

would finance the purchase of the revenue stream by issuing bonds. The special purpose trust is to be a non-profit public benefit corporation whose board members are those of the State Public Works Board, a state entity. The purchased revenue stream would be pledged to repayment of the bonds. The proceeds from the sale of the revenue stream (originally estimated to be \$8 billion) would be deposited into a newly created special fund (the Revenue Fund). The bulk of the sale proceeds will not immediately be used for such programs, however, as most of the proceeds will be immediately loaned to another newly created special fund, the Jobs Fund. The Jobs Fund will also receive the proceeds of a proposed oil severance tax. The Jobs Fund will fund programs that are ostensibly job-related and that historically have been or could be funded by the General Fund (thereby avoiding some reductions otherwise proposed by the Governor to such General Fund programs), will repay state obligations currently owed by the General Fund to local government, and over time (perhaps 20 years) will repay the loan from the Revenue Fund. Money on deposit in the Revenue Fund would be transferred annually to the Beverage Container Recycling Fund in amounts needed for the existing and additional recycling programs.

#### *Bond Standard*

When we give advice regarding the validity of bonds, we adopt a conservative approach. When the Attorney General delivers a written unqualified approving opinion upon the issuance of bonds, the opinion concludes that the bonds are valid and binding obligations under state law. To the extent that we are aware at the time of issuing the opinion that the bond financing (including the intended use of bond proceeds) is not consistent with the law (based on a constitutional prohibition or otherwise), we cannot give an unqualified opinion.

The unqualified opinion standard is very high. Generally speaking, a bond opinion is unqualified if counsel 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.” (Nat. Assoc. of Bond Lawyers Comm. on Opinions and Documents, Model Bond Opinion Report (February 2003); see also *Weiss v. Securities and Exchange Comm.* (D.C. Cir. 2006) 468 F.3d 849 [standards published by the National Association of Bond Lawyers could be presumed by bond purchasers to apply to bond opinions].)

#### *Proposition 58*

As you know, Propositions 57 and 58 were initiatives on the March 2, 2004 direct primary ballot pertaining to deficit financing. They were each dependent upon the passage of the other and the voters approved both. Under Proposition 57, the voters authorized the issuance of Economic Recovery Bonds to finance the “accumulated state budget deficit” remaining in existence as of June 30, 2004. Although Proposition 58 makes several other changes in the law, the primary focus here is on the meaning of the initiative’s prohibitions on future deficit financing. (See Cal. Const., art. XVI, § 1.3, subd. (c).) The constitutional prohibition is stated as follows:

Subsequent to the issuance of any state bonds described in subdivision (a) [the Economic Recovery Bonds], **the State may not obtain moneys to fund a year-end state budget deficit, as may be defined by statute, pursuant to any of the following:** (1) indebtedness incurred pursuant to Section 1 of this article [general obligation bonds] . . . .” (2) a debt obligation under which funds to repay that obligation are derived solely from a designated source of revenue, or (3) a bond or similar instrument for the borrowing of moneys for which there is no legal obligation of repayment. . . .

(Cal. Const., art. XVI, § 1.3, subd. (c), added by initiative, Direct Primary (March 2, 2004) (boldface added).)

#### *Interpretation of a Constitutional Provision*

In the absence of a conflict with the federal Constitution, the California Constitution is the supreme law of the land in California. (See *Pooled Money Investment Bd. v. Unruh* (1984) 153 Cal.App.3d 155, 160 (neither transient urgency nor abstract practicality can override the state constitution).) The California Constitution itself emphatically states: “The provisions of this Constitution are mandatory and prohibitory, unless by express words they are declared to be otherwise.”.) (Cal. Const., art. 1, § 25.) The Legislature cannot override constitutional limitations by statute. (See, e.g., *In re Marriage Cases* (2008) 43 Cal.4th 757, 852, superseded on other grounds by constitutional amendment, Cal. Const., art. 1, § 7.5, added by initiative, General Election (November 2008).)

Constitutional amendments are interpreted by determining the intent of the voters in approving the initiative in question. (*Delaney v. Superior Court* (1990) 50 Cal.3d 785, 798.) California courts would start with an examination of the text of the initiative itself, rather than with a review of the voter materials. (See *Arias v. Superior Court* (2009) 46 Cal.4th 969, 979 (attention must first be given “to the words of the initiative measure, as they generally provide the most reliable indicator of the voters’ intent.”).) If the meaning of the provision in question is unambiguous, *the court must base its conclusions upon the language of the initiative rather than going forward with a review of extrinsic evidence.* (See *People v. Leal* (2004) 33 Cal.4th 999, 1008 (“There is no need to construe a provision’s words when they are clear and unambiguous and thus not reasonably susceptible of more than one meaning.”).) But if there are ambiguities, the courts can move forward and consider extrinsic evidence, such as the official voters’ pamphlet. (*People v. Castro* (1985) 38 Cal.3d 301, 310.)

#### *Analysis*

Proposition 58 expressly describes three financing methods that cannot be used to fund future year-end deficits. One of the three prohibited forms of borrowing is a debt obligation under which funds to repay that obligation are derived solely from a designated source of revenue. In the case of the proposed securitization, the bonds would be repaid solely from the future revenue stream produced by the regulatory fees. The plain language of Proposition 58 expressly prohibits this form of borrowing if it is used by the State for the prohibited purpose of “obtain[ing] moneys to fund a year-end state budget deficit.”

Unfortunately, the meaning of this critical phrase as used in Proposition 58 is far from clear. An initial ambiguity arises from the fact that Proposition 58 does not expressly limit its prohibition to situations in which the State itself *issues* any of the three described forms of debt. Rather the prohibition more broadly extends to any of the described borrowings by which the State “obtains money” for the prohibited purpose. Arguably, therefore, Proposition 58 could extend to a transaction in which the State does not itself issue bonds but it obtains money *as a result of* the three described forms of borrowing. The proposed transaction results in the State obtaining money sourced to revenue bonds issued by the special purpose trust.

In the case of the proposed securitization, a court may conclude that it is irrelevant that the State does not itself issue the revenue bonds and focus instead on the fact that the State “obtains money” as a result of the securitization in the form of the proceeds of the sale of the revenue stream. Alternatively, even if the court concluded that Proposition 58 only applied to state-issued debt, in looking at the substance of the proposed transaction, a court might give little weight to the fact that the bonds are issued by a special purpose trust because of the close identity of the special purpose trust with the State and the fact that the trust is created solely for the limited purpose of this securitization. A court may deem the special purpose trust a state actor for purposes of Proposition 58.

A further important ambiguity in Proposition 58 arises from the fact that the key phrase, “to fund a year-end state budget deficit,” is not defined. The initiative instead allows the Legislature to define the phrase at some later time by statute, but only if the Legislature chooses to do so. The Legislature has yet to provide a definition of “year-end state budget deficit” as permitted by Proposition 58. On one hand, the expression may mean that that the voters intended that the prohibition on deficit financing would only apply to subsequent financings of or relieving aggregate deficits that actually remain *at the close* of a budget year. On the other hand, the expression could more broadly mean that such financing prohibitions also apply to financing of deficits *at any time during a budget year* if such financings would have the effect of reducing or preventing an otherwise expected year-end budget deficit. The latter interpretation is supported by a comprehensive reading of Proposition 57 and 58. These measures were approved together as a means of addressing a current deficit problem and also *reforming the budgetary process* to avoid any such future deficits. Proposition 58: (1) established procedural steps for the Governor and the Legislature to take remedial budgetary action earlier in future budget years, and also (2) banned the use of deficit financings in lieu of other substantive measures to address future budget deficits.

Under either interpretation of year-end state budget deficit, the proposed transaction could be suspect. The Assembly proposal itself indicates that the ultimate purpose of borrowing \$8 billion in budget year 2010-11 is to fund expenditures in the 2010-11 budget year, thereby arguably borrowing to fund a 2010-11 year-end budget deficit. But since the General Fund is projected to close the 2009-10 budget year with a negative balance, the proposed borrowing in 2010-11 may also be viewed as a method of funding the 2009-10 year-end budget deficit carried over into the 2010-11 budget year.

We further note that if a court concludes that the net result of the securitization is to fund a year-end state budget deficit, a court may disregard the form of the transaction and look solely to its substance and determine that it violates Proposition 58. A court may be more likely to do so where the securitization does not appear to have any significant independent economic purpose or necessity. In this case, the proposed transaction produces a disproportionate amount of funds relative to the short-term needs for the beverage recycling program. The transaction is neither the only viable nor the most straightforward alternative to funding the beverage recycling program's short-term needs, such as raising the existing regulatory fees. In these circumstances, a court may well conclude that the proposed securitization has been undertaken for purposes *other* than funding the recycling programs, such as funding a year-end state budget deficit.

Reducing the size of the securitization to more closely approximate the needs of the recycling programs may be helpful to avoid a violation of Proposition 58. However, regardless of the amount obtained from the securitization, because the money from the securitization can ultimately be traced in the transaction to General Fund purposes (to repay General Fund obligations, and/or fund General Fund programs), a court may conclude that the true purpose of the transaction is to obtain money to fund a year-end state budget deficit. The fact that the securitization proceeds do not go directly into the General Fund may not matter for purposes of Proposition 58 if the bulk of the proceeds are used for a loan to a "special fund" that pays for General Fund programs and obligations. A court may reasonably conclude that obtaining money from the proposed securitization undertaken during the 2010-11 budget year that is then used (via an interfund loan) to provide funding for what would otherwise be General Fund obligations and programs, is "obtaining money to fund a year-end state budget deficit."

In looking at the overall transaction, including the fact that it was introduced as part of an overall budget proposal, we believe that a court could reasonably conclude that the securitization and companion interfund loan to the Job Fund were simply a series of steps by which the State obtained money to fund a year-end state budget deficit in violation of Proposition 58. Based on our understanding of the proposed transaction, our office could not provide an unqualified opinion that the proposed transaction is valid under Proposition 58.

If you have any questions or concerns regarding this letter or if there are additional facts that we have not considered, please do not hesitate to contact me.

Sincerely,

*Constance L. LeLouis*

Constance L. LeLouis  
Supervising Deputy Attorney General

*by CHS*

For EDMUND G. BROWN JR.  
Attorney General