



VALIDATION ACTIONS AND PUBLIC FINANCE

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Validation procedures have long enabled public entities to confirm the legality of various actions, including contractual agreements and the issuance of public debt. To validate these actions the public entity, in effect, sues all persons deemed to be interested in the matter. At the heart of the court's decision is a determination that the actions are allowable under existing law and, thus, valid.

The court could also find the actions of a public agency to be invalid. This possibility provides private citizens as well as other public entities the opportunity to challenge certain public transactions, including some contracts and bonds, by seeking validation of those transactions. In either case, the validation process intends to eliminate uncertainty by obtaining a judicial determination of the validity of the transaction based on existing law. In the context of a bond issue, a validation serves to remove from the pricing equation the uncertainty regarding the validity of the transaction.

The role of validation procedures in municipal finance has become more visible with the passage of Chapter 723, Statutes of 2000 (AB 2300, Florez). New procedures enacted by AB 2300 intend to curb abuses in the sale of land-based municipal bonds carried out by joint powers authorities, particularly those authorized under the Marks-Roos Bond Pooling Act of 1985.

Foundations and Premises

Chapter 9 (commencing with Section 860) of Title 10 of Part 2 of the California Code of Civil Procedure permits a public agency to validate any matter that the public agency has been authorized to validate pursuant to other laws that provide for such actions, including the authorization to issue bonds. In general, most validation actions relate to public financings.

Section 6516.6 of the Government Code forms the basis for any validation actions brought by a joint powers authority and applies to the Marks-Roos Act. It reads, "an action to determine the validity of any bonds issued, any joint powers agreements entered into, any related agreements, including, without limitation, any bond

indenture or any agreement related to the sale, assignment, or pledge entered into by a joint powers authority or a local agency...may be brought by the joint powers authority pursuant to Chapter 9 (commencing with Section 860) of Title 10 of Part 2 of the Code of Civil Procedure."

It is noteworthy that validation actions under Section 860 of the Code of Civil Procedure take place in "the nature of a proceeding *in rem*." *In rem* rights, as opposed to *in personam* rights, are proprietary in nature and have particular value in land-based transactions. Historically they were used to determine the truthfulness of claims to property whereby the truth of a claim was determined by asking anyone who opposes that claim to state so publicly.

Public agencies may seek to validate their actions through writ of mandamus, as well. A mandamus validation differs from a validation under Section 860 in that it asks the court to mandate that the public agency complete a specific transaction. The mandate in effect validates the legality of the transaction. This article focuses on validations that are provided for under Chapter 9 of the Code of Civil Procedures.

Common Uses of Validation Actions

A public entity may choose to validate an action, including the authority underlying a bond issuance or the procedural elements that comprise the deal, in order to erase any uncertainty. To do so the public entity files a validation action in court, in effect, asking those who would contest their decisions to come forward. If opposition should manifest, the public agency is free to withdraw or restructure the deal.

The issuance of pension obligation bonds is one area where validation actions have been used in recent years. Article XVI, Section 18, of the State Constitution prohibits cities and counties from incurring indebtedness exceeding one year without an election. Pension obligations do not fit into any of the well-recognized exceptions to this Constitutional debt limit. But they do qualify for a lesser-known legal exception under the guise of an "obligation imposed by law." Because the authority for this exception

has not been substantially developed by case law, bond counsel may suggest that the public agency validate the debenture or contract as truly an obligation imposed by law.

Shortly after the passage of the Mello-Roos Community Facilities Act of 1982, public agencies began to use the validation procedure to resolve questions concerning the nature of these arrangements. The Mello-Roos Act allows certain public entities to finance the construction or acquisition of facilities or the provision of services by imposing a special tax on certain properties located within a community facilities district. Validation actions were used to affirm that these special taxes were not ad valorem property taxes, which were addressed by Proposition 13.

Two seminal cases addressing the debt limit imposed by the State Constitution were brought as mandamus validation actions. The two cases, *City of Los Angeles v. Offner* and *Dean v. Kuchel*, now provide that a long-term lease obligation entered into by a city, county, or school district as lessee will not be considered an “indebtedness or liability” under the Constitutional debt limit if the lease meets certain criteria.

The validation process may also be used whenever a public agency is entering into certain types of contracts related to financing. These contracts may pose some element of doubt. The authority to enter into a contract, for example, may not be well established by precedent or the relationship between obligators may be convoluted. In these cases, validation serves to reduce the risk that any future action that may be contingent upon the contract will be jeopardized by an invalid contract.

Private citizens as well as public entities may use the validation procedure to challenge the actions of a public agency. The most notable case of this kind is *City of San Diego v. Rider* in which Rider challenged the validity of a financing scheme for the expansion of a stadium. Rider claimed that the arrangement between the city and a joint powers authority to issue bonds was an overt attempt to circumvent the Constitutional debt limit.

The Role of Counsel

The use of the validation process serves to eliminate doubt with respect to various actions of public agencies. In doing so, however, it does not supplant the role of legal counsel, who has historically rendered opinions on the legality of contractual agreements and bonds.

In the process of delivering an unqualified opinion as to the legality of bonded indebtedness, bond counsel uses a standard that requires a high level of certainty. To deliver an unqualified opinion, bond counsel must conclude that it would be unreasonable for a court to reach a decision contrary to the opinion of bond counsel. Where an issue is clearly established in existing case law or by statute or by well-established practice, bond counsel is likely to judge a

transaction as legal and binding. However, if an issue has not been addressed by the courts and/or involves new types of financings, bond counsel may recommend that the public agency seek to validate the transaction if it wishes to proceed.

Procedural Aspects of Validation

Chapter 9 outlines the procedural rules for validating public acts, including public contracts and the authorization to issue bonds. As set forth in the Code of Civil Procedure, these acts may be validated for 60 days following their occurrence. The validation process begins when a party files a complaint and publishes a summons once a week for three successive weeks in a newspaper of general circulation. The summons is to be directed to “all persons interested in the matter of (specifying the matter),” and advise all interested persons that they may contest the legality or validity of the matter in person or in written form within a set time period.

The summons must provide a detailed summary of the matter the public agency or interested person seeks to validate. In addition, the summons must state that a person who contests the legality or validity of any matter will not be subject to punitive action.

Publication of the summons is the means by which the court can establish *in rem* jurisdiction. The act of announcing the matter and providing for a method of responding to the matter allows the court to issue a judgement that is binding on all persons whether or not they were parties to the action and to all issues which could have been considered whether or not they were.

A person, corporation, or other public agency may also initiate a validation action against a public agency. Such actions are usually referred to as “reverse validation actions.” In these cases, the public agency is the defendant and is served with a summons and complaint in the same manner as provided under civil law. Furthermore, the plaintiff in the action must follow the strict procedural requirements of Chapter 9, including properly addressing, publishing, and serving the summons within the time constraints of Chapter 9, or face the risk of having the action dismissed.

The 60-day period for filing a validation action against bonds, warrants, contracts, obligations, and evidence of indebtedness begins when they are authorized by the public agency. Bonds and warrants, in particular, are authorized when the governing body of the public agency adopts a resolution or ordinance authorizing their issuance.

Chapter 9 also provides that validation actions receive calendaring preference over all other civil actions before the court. This expedites the procedure in an effort to bring it to a speedy conclusion. In addition, Chapter 9 does not preclude or supplant other efforts to validate any matter.

The findings of the court in the matter being validated are binding and conclusive. The process, however, does provide for a 30-day appeal. If there is no answering party in the validation action, the appeal can address only the

jurisdiction of the proceedings. That is, a person may appeal on the grounds that the summons process did not fully capture all those who would have been interested in the action.

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