HENRY MCMASTER
ATTORNEY GENERAL

August 19, 2009

The Honorable Don C. Bowen
Member, House of Representatives
1176 Embassy Drive
Anderson, South Carolina 29625

The Honorable W. Brian White
Member, House of Representatives
Post Office Box 970
Anderson, South Carolina 29622

Dear Representatives Bowen and White:

We received your letter requesting an opinion of this Office as to "the permitted generation and use of bond premiums in matters of school district finance." In your letter, you informed us that "[p]ursuant to a bond referendum held in a school district on April 24, 2007 (the 'Bond Referendum'), the qualified electors of the school district approved the issuance of not exceeding $140,000,000 of general obligation bonds for certain projects." In addition, you informed us that

> [T]he Board of Trustees of the School District adopted a resolution authorizing the issuance and sale of $77,000,000 general obligation bonds of the School District (the "Bond Resolution"). Among other things, the Bond Resolution restated the purposes described in the Bond Referendum and delineated above. These purposes were also restated in the Official Statement dated June 18, 2008 prepared under the supervision of the assistant superintendent of the school district and provided for the purpose of furnishing information in connection with the sale of bonds.
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> Section 17 of the Bond Resolution provided in boldface, capitalized terms that "No proposal for the purchase of less than all of the bonds or at a price less than 102.0% of their par value will be considered.

> This provision resulted in a "forced premium" of $1,540,000 (the "Premium"), for a total amount of $78,540,000 received by the school district in proceeds from the sale of $77,000,000 in bonds.
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> The Federal Tax Certificate, which also restated the purposes delineated above and which was executed by the district superintendent on closing of bond issue, states that the "balance of . . . $78,405,000.00 (the "Construction Proceeds") . . . plus investment earning thereon will be used to provide funds to defray a portion of the costs of the Projects" and "the Construction Proceeds and anticipated earnings thereon do not exceed the amount necessary to complete the construction of the Projects."
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> Public statements attributed to the school district's superintendent indicate that at least a portion of the Premium was applied to ordinary operating expenses of the school district "to make up for a 2 percent cut in money from the state." The public statement attributable to the superintendent described the Premium as "bond incentive money" which is "a premium bond companies paid in order to bid on the school district's $140 million building bond, passed by referendum in 2007." Hence, the school district applied some portion of the Premium to purposes other than those described in the Bond Referendum, the Official Statement, and certificates executed in conjunction with closing of the bond sale.

Based on this information, you ask for an opinion addressing the following questions:

> 1. May a school district properly impose as a condition of purchase of its general obligation debt a purchase price exceeding par, such that proceeds will be generated in excess of that amount contemplated by the referendum authorizing issuance of the indebtedness or the debt limit prescribed by the Constitution?
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> 2. May proceeds derived from a purchase price exceeding par be expended for purposes other than those specifically described in the referendum, bond resolution, offering statement and closing documents?

> 3. Under the provisions of the School Bond Act, may proceeds of the sale of general obligation indebtedness be expended for any purpose other than capital improvements, and particularly, for operating expenses of the school district?
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> 4. Must a school district charge against its authorization under a referendum or its Constitutional debt limit the proceeds of general obligation indebtedness in excess of the amount contemplated by the referendum or limited by the Constitution?

Law/Analysis

Initially, you inquire as to a school district's ability to require that bonds be issued at a premium. We first look to the provisions of the School Bond Act located in chapter 71 of title 59 of the South Carolina Code (2004 & Supp. 2008). Section 59-71-140 of the South Carolina Code (2004) states that bonds "must be sold at a price of not less than par and accrued interest to the date of delivery." While this provision prohibits bonds from being issued at a discount, it does not similarly prevent bonds from being issued at a premium. However, as you point out in your letter, issuing bonds at a "forced premium" could create a mechanism by which a school district can receive proceeds in excess of the amount authorized by referendum or in excess of the school district's debt limitation as provided for under the South Carolina Constitution.

According to your letter, the school district takes the position that in addition to the fact that the School Bond Act does not prohibit a school district from requiring that bonds be purchased at a premium, the premium is not a debt of the school district and does not have to be repaid. However, you make the point that while the premium does not increase the school district's debt, it will cost the taxpayers more because if bond purchasers are required to pay a premium they will demand a higher interest rate and as a result the school district's cost to service the bonds will increase. In your letter, you cited to a case decided by the Kentucky Court of Appeals finding the imposition of a premium on bonds to be improper. In Bell v. Board of Education of Barren County School District, 343 S.W.2d 804 (Ky. 1961), a county board of education gained approval to issued bonds at a premium in hopes of using the premium to cover the expenses of issuing the bonds. With regard to the premium, the Court explained:

> If the bonds should be sold at a premium, as they are required to be done here, of course, there would be no increase in the debt. While the plan presented would not prima facie increase the debt, it would as a matter of reality result in the Board of Education having to pay the cost ultimately through a higher rate of interest than if the bonds

> were offered at par. As stated above, the order of the Board requires that the bonds be sold at a premium of $15 each. This would yield altogether $143,115 for a debt of $141,000. The competition in the bidding, if any, rests on the rate of interest to be paid. It is not to be supposed that a bidder will offer the same or a lower rate of interest on a $1,000 bond when he has had to pay $1,015 for it. Therefore, ultimately the premium would be funded and would have to be paid out of the special taxes.

Id. at 808. Ultimately, the Court ruled that the premium on the bond was invalid. Id.

In a subsequent decision, the Kentucky Court of Appeals upheld its decision in Bell. In Dixon v. Elliott County, 357 S.W.2d 852 (Ky. 1962), the County's proposed bond issue was approved by the voters at $100,000. Id. at 854. However, the order directing the sales and advertisement of the bonds requires that bids be "not less than par plus a reasonable minimum premium" in order to provide "for expenses in connection with the validation, printing, advertisement and issuance of said bonds." Id. The Court stated:

> We held in the Bell case that as the higher rate of interest would be paid out of the special tax levy, the scheme was equivalent to increasing the amount which the taxpayers would ultimately have to pay. The requirement in the present case must be likewise regarded. The authority derived from the vote of the people to issue $100,000 in bonds carried the presumption or necessary implication they would be offered for sale at par value, that is $1,000 in money for a $1,000 bond. The people could well suppose that the rate of interest would be computed on that principal and on no greater sum. As pointed out in the Bell case, it is not to be supposed that a bidder will offer the same or a lower rate of interest on a $1,000 bond when he will have to pay more than that for it. Of course, if bids were to be on bonds to bear a definite rate of interest, the competition would be based upon the principal-par or more or less. But in this kind of proposal the rate of interest is itself the basic factor in the competition. The fiscal court was without right to change materially the terms or conditions of the proposition voted upon. Percival v. City of Covington, 191 Ky. 337, 230 S.W. 300; Reynolds v. Bracken County, 192 Ky. 180, 232 S.W. 634; Riddell v. Boone County, 183 Ky. 77, 208 S.W. 323.

Id. at 855.

As you mentioned in your letter, South Carolina courts have yet to address the issue of forced premiums. In addition, other than the two Kentucky Court of Appeals cases cited above, we were unable to find any cases from other jurisdictions addressing this issue. As we mentioned above, the School Bond Act does not prohibit the sale of school bonds at a premium. Thus, we find no South Carolina law prohibiting a bond from being issued at a specified premium. However, following the reasoning of the Kentucky Court of Appeals, by forcing bonds to be sold at a premium, a school district would be trading principal debt for an increase in its interest expense. Thus, our courts could very well follow this reasoning and find the imposition of such a premium to be improper. But, until our courts specifically address this issue, we cannot conclude with certainty as to how a court would view this type of transaction.

Next, you question whether or not the premium received from the issuance of the bonds may be expended for "purposes other than those described in the referendum, bond resolution, offering statement and closing statement?" While the School Bond Act itself does not address this particular question, we can imagine that if these documents describe a particular purpose that is different from what the bond proceeds will actually be used for, the public may be misled in approving the issuance of the bonds. As we have stated in previous opinions "a ballot referendum may not confuse or mislead the voter." Op. S.C. Atty. Gen. May 8, 2003. We explained in detail, in an opinion issued in 2003, the general requirements in this regard:

> The general test applied by our Supreme Court as to whether a particular referendum is upheld or set aside is whether "when viewed as a whole, [the referendum] ... would likely mislead the average voter." Lowery v. Bright, 234 S.C. 279, 107 S.E.2d 769 (1959). It is the purpose of a bond referendum to "determine the will of the voters upon the assumption of a public debt to the amount of and for the object proposed." Fairfax County Taxpayers Alliance v. Bd. of County Supervisors of Fairfax, 202 Va. 462, 117 S.E.2d 753 (1961). The general purpose of the debt "must be stated with sufficient certainty to inform and not mislead voters as to the object in view . . . ." The painstaking details of the proposed work or improvements, of course, need not be set out in the ballot. Id.
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> In Tipton v. Smith, et al., our Supreme Court articulated the general standard for legal sufficiency of a referendum. Quoting with approval the Massachusetts case, In re Opinion of Justices, 271 Mass. 582, 171 N.E. 294, 297, 69 A.L.R., the Court stated that the referendum

> ... must be complete enough to convey an intelligible idea of the scope and import of the proposed law. It ought not to be clouded by undue detail, nor yet so abbreviated as not to be readily comprehensible. It ought to be free from any misleading tendency, whether of amplification, of omission, or of fallacy. It must contain no partisan coloring. It must in every particular be fair to the voter to the end and that the intelligent and enlightened judgment may be exercised by the ordinary person in deciding how to mark the ballot.
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> 93 S.E.2d at 642.
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> In the Tipton case, the Court found that the ballot in question was materially misleading and thus declared the election invalid. See also, Heinitsh v. Floyd, 130 S.C. 434, 126 S.E. 336, 337 ["To give effect to the [wording of the ballot] would be to approve the submission of constitutional amendments under forms which would procure their adoption by deceit."].

Id. However, we noted that the determination of whether a particular bond referendum is misleading is a factual determination that only a court can decide. Id.

Nonetheless, in the 2003 opinion, we considered the alleged misleading information provided by the requestor, which involved disclosure of information surrounding the acquisition of property adjacent to Dreher High School which was purchased using proceeds from the sale of school bonds by Richland School District One. Id. According to the opinion, the requestor claimed that "voters were not properly apprised the fact that School District One was in the process of purchasing the equivalent of an entire city block in property adjacent to the present Dreher site." Id. Moreover, the requestor indicated that voters were lead to believe that the Dreher High School renovations or expansions would be made on the existing Dreher property without any additional property acquisition. We found support for the requestor's position on the school district's web site which indicated that the school was to be rebuilt "'on site of the present school facility.'" Id. (quoting the Richland One web site). In addition, we noted that the referendum ballot itself "states that the purpose of the bond issuance as it affects Dreher would be to 'construct, equip or furnish a replacement facility for or renovations and/or expansions to the existing Dreher High School.'" Id. (quoting the referendum ballot). While we could not make a definitive conclusion with regard to whether the voters were mislead, based on this information, we concluded that "it appears likely that at least some facts to support a legal challenge to this portion of the referendum are in the public domain." Id.

In your letter, you quoted a portion of the language from the bond referendum describing the purposes for which the bond proceeds will be used as follows:

> Shall the Board of Trustees of [the school district] of [name of county] County, South Carolina (the "School District"), be authorized to issue and sell, either as a single issue or as several issues, general obligation bonds of the School District in the aggregate principal amount of not exceeding $140,000,000, the proceeds of which shall be applied to defray the costs (including architectural, engineering, legal and related fees) of the following:
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> 1. Acquiring land and constructing thereon, and equipping and furnishing two (2) new middle schools and a new elementary school;
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> 2. Making improvements and additions to, and equipping and furnishing [name of school] and [name of school];
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> 3. Making improvements, renovations and additions to [name of school] in order to convert such school to an Arts Magnet School (grades 6 though 12);
>
> 4. Constructing, equipping, and furnishing an auditorium at [name of facility];
>
> 5. Making improvements (including, but not limited to, HVAC improvements), additions, renovations and equipping and furnishing other existing elementary schools, middle schools and high schools and other existing school facilities?

In addition, in your letter, you indicated the resolution passed by the school district's board of trustees "restated the purposes described in the Bond Referendum." Moreover, you state that "[t]hese purposes were also restated in the Official Statement dated June 18, 2008 prepared under the supervision of the assistant superintendent of the school district and provided for the purpose of furnishing information in connection with the sale of bonds."

From the documents referred to above, we would assume that the voters understood that the proceeds of the bonds were to be used for the construction, renovation, equipping, and furnishing of schools located in the school's district. However, it is your understanding based on public

statements by the school district's superintendent that "at least a portion of the Premium was applied to ordinary operating expenses of the school district . . . ." Thus, you are concerned that the documents are misleading and that the elector's were misled when voting to adopt the referendum.

As noted in our 2003 opinion, this Office cannot make factual determinations. Op. S.C. Atty. Gen., May 8, 2003. Only a court may make factual determinations. Id. Thus, we cannot decide with finality whether or not the voters would be misled by the referendum, bond resolution, offering statement, and closing documents. However, based on the information provided by you, it does not appear that these documents mentioned that any proceeds from the bonds would be used for school operating expenses. Thus, a court could make the conclusion that these documents misled voters as to the purpose for which the bond proceeds were to be used. Nonetheless, only a court may make this decision with finality.

Next, you inquire as to whether the provisions of the School Bond Act allows proceeds from the sale of general obligation indebtedness to be used "for any purpose other than capital improvements, and particularly, for operating expenses of the school district?" According to section 59-71-180 of the South Carolina Code (Supp. 2008):

> The proceeds derived from the sale of the bonds must be deposited with the treasurer of the county in which the operating school unit is located, in whole or in part, in a special fund to the credit of the operating school unit and must be applied solely to the purposes for which the bonds were issued, except that the accrued interest, if any, must be used to discharge in part the first interest to become due on the bonds.

(emphasis added).

As we stated previously, based on the information you provided including a portion of the referendum, we understand that the proceeds from the issuance of the bonds are to be used for the construction, renovation, equipping, and furnishing of schools located in the school's district. We did not find any indication in your letter that the bonds were to be used for the school district's operating expenses. Moreover, as we noted in a prior opinion: "The School Bond Act prohibits the expenditure for any item that is not a part of the capital expenditure purpose for which the bonds were issued." Op. S.C. Atty. Gen., June 7, 1993. Moreover, in that same opinion, we specifically stated that funds resulting from the School Bond Act "are special funds which are not to be disbursed to the school district under § 59-69-215 [the provision governing the county treasurer's disbursement of funds for school operating purposes]." Accordingly, we believe proceeds from the sale of school

bonds pursuant to article 1 of chapter 71 of title 59 must be expended for the purposes for which the bonds were issued and be capital expenditures. We do not believe these proceeds may be used for the school district's operating expenses.

Lastly, you ask whether or not the proceeds of general debt obligation indebtedness in excess of the amount contemplated in a referendum or constitutional debt limitation must be charged against the amount authorized. In other words, we believe you are inquiring as to how the presence of a forced premium will affect the amount authorized in the bond referendum and the constitutional debt limitations for the school district. In determining the amount of the bonds for purposes of the amount authorized by a referendum or the amount considered when determining the bonds' impact on the school district's constitutional debt limitation, only the principal amount on the face of the bonds is considered. If the bonds are issued at a premium, such a premium is generally the result of market forces due to a difference in the interest rate on the face of the bonds and the market interest rate. Therefore, we do not believe that premiums are generally considered debt, but rather the market's reaction to the interest rate on the face of the bonds. Thus, we do not believe that premiums generally count against the debt limit set forth in the bond referendum or the school district's debt limit imposed by the Constitution.

However, as discussed above, if the bond issuer requires a premium to be paid, the market will force the issuer to pay a higher interest rate and will result in the school district paying more in interest than if the bonds had been issued at face value. While certainly, the cost to the issuer increases under this scenario, do not believe a court is likely to convert that additional expense as a result of market manipulation into debt chargeable against the debt limitation established by the referendum or the constitutional debt limitation. In fact, in our research, we were unable to find a decision by any court in any jurisdiction determining that a premium should be considered debt for purposes of debt limitations. Therefore, while we are not free from doubt, we do not believe the premium is chargeable against the amount of debt approved by the voters in the referendum or the school district's constitutional debt limitation. Nonetheless, we recognize that this determination will allow school districts to manipulate the market to receive additional proceeds from the sale of their bonds while not impacting their debt limitation. If such a result is not the intention of the Legislature, we suggest the Legislature seek to clarify that under certain circumstances bond premiums may be chargeable against both the amount of the debt authorized by referendum and/or the school district's constitutional debt limitation.

Conclusion

Based on our review the provisions contained in the School Bond Act, we did not find a provision preventing a school district from issuing bonds at a mandated premium. Nonetheless, we

acknowledge that our courts, which to date have not addressed this issue, could follow the reasoning of the Kentucky Court of Appeals and find such actions by a school district to be improper.

We believe the use of bond proceeds in a manner not described in the referendum, bond resolution, offering statement, and closing documents may be considered misleading and could jeopardize the validity of the bond referendum. However, the determination as to whether a referendum or information surrounding the referendum is misleading is factual in nature and therefore, can only be decided by a court. Nonetheless, we believe the School Bond Act is clear that bond proceeds may only be used for the purposes for which they were issued. Additionally, in accordance, with a prior opinion of this Office, these proceeds may only be used for capital expenditures and may not be used for school district operating expenses.

Lastly, in a situation like the one described in your letter, we understand that by forcing a bond premium, the school district is not only increasing the proceeds it receives from the sale of bonds, but as a result, is increasing its interest expense. Thus, it appears as if the school district is manipulating the market in order to increase proceeds without increasing the amount of principal debt. While such a manipulation of the market causes us concern because school districts could use it to skirt the debt limitations established in the referendums approving the bonds and their constitutional debt limitations, we were unable to find any legal provision or any case law in which premiums were considered to be debt for purposes of debt limitations. Thus, until our courts make this determination or our Legislature passes legislation to prevent such a transaction, we cannot opine that premiums should be treated as principal debt for purposes of debt limitations.

Very truly yours,

Henry McMaster
Attorney General

Cydney M. Milling

By: Cydney M. Milling
Assistant Attorney General

REVIEWED AND APPROVED BY:

Robert D. Cook

Robert D. Cook
Deputy Attorney General