



NORTH CAROLINA

OFFICE OF THE TREASURER

JANET COWELL, TREASURER

March 25, 2013

The Honorable Bob Rucho
North Carolina Senate
300 North Salisbury Street
Raleigh, North Carolina 27603-5925

RE: Opinion from Outside Bond Counsel for Senate Bill 81

Dear Senator Rucho:

Based on our discussions with you and your staff on Tuesday, February 26, 2013, we have obtained an opinion from an outside bond counsel on Senate Bill 81 ("SB 81") which establishes the Charlotte Regional Airport Authority ("Authority") and requires transfers of ownership and control of Charlotte Douglas International Airport ("Airport") from the City of Charlotte ("City") to the Authority. Immediately following our discussions, we invited bids from two law firms and recommended the selection of Hawkins, Delafield, and Wood, LLP ("Hawkins") because their law practice is devoted primarily to public finance. Furthermore, Hawkins has acted as bond counsel and underwriters' counsel for North Carolina issuers for many years, although they have not been involved with any transactions of the City or the Airport. Our recommendation of Hawkins was approved by the both the Attorney General's Office and the Governor's Office.

As the enclosed opinion states, SB 81 raises a number of legal issues including (1) potential claims of impairment of bondholder rights under the Contract Clause of the U.S. Constitution, (2) potential events of default under the documents governing the issuance of the City's airport revenue bonds, and (3) potential violation of G.S. § 159-93, the State's agreement with holders of revenue bonds such as the City's airport revenue bonds. Moreover, as the opinion goes on to discuss, these issues identified with SB 81 give rise to several matters that have never been decided by North Carolina courts. We believe such legal uncertainty could result in potential prolonged litigation.

Furthermore, we believe such legislation could have an impact on the North Carolina municipal bond market. The fact that a North Carolina local government issuer of bonds has lost ownership and control of the asset as a result of General Assembly action would have to be disclosed in the official statement of any future revenue bond offerings. This disclosure could affect the cost of borrowing and desirability of North Carolina revenue bonds.

With these considerations in mind, we urge the General Assembly to proceed cautiously on SB 81. If the State and Local Government Finance Division can provide additional information please do not hesitate to contact me.

Sincerely yours,

A handwritten signature in black ink that reads "T. Vance Holloman".

T. Vance Holloman
Deputy State Treasurer and
Secretary, Local Government Commission



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March 25, 2013

Hon. T. Vance Holloman
Deputy Treasurer
State and Local Government Finance Division
North Carolina Department of State Treasurer
325 N. Salisbury Street
Raleigh, NC 27603-1385

Re: North Carolina Senate Bill 81 ("SB81")

Dear Mr. Holloman:

At the request of the Department of State Treasurer, we provide below our views on SB81 before the General Assembly of North Carolina, Session 2013, which establishes the Charlotte Regional Airport Authority ("Authority") and requires the transfer of ownership and control of Charlotte Douglas International Airport ("airport") from the City of Charlotte ("City") to the Authority. At the outset, we stress that this is a limited review as described herein, and not a full diligence or legal feasibility review of the transactions proposed by SB81.

As more fully discussed below, the adoption and implementation of SB81 raise a number of legal issues, including: (i) potential claims of impairment of bondholder rights under the Contract Clause of the U.S. Constitution, (ii) potential events of default under the documents governing the issuance of the City's airport revenue bonds and (iii) potential conflicts with G.S. § 159-93, a covenant of the State with holders of revenue bonds such as the City's airport revenue bonds. Constitutional claims under the Contract Clause are fact-specific, and the lack of controlling North Carolina case law based on the facts presented here, and other factors, make the result uncertain in North Carolina. Potential resolutions include bondholder consents and bond defeasances.

General Description of SB81

We have reviewed SB81 in the form of Proposed Committee Substitute S81-PCS15084-RBx-4. SB81 would create the Authority as a body corporate and politic,

consisting of 13 members who would constitute its governing board. Individual members would be appointed variously by the City Council and Mayor of the City of Charlotte, the Boards of Commissioners of Mecklenburg, Cabarrus, Gaston, Iredell, Lincoln and Union Counties, the General Assembly upon recommendation by the Speaker of the House of Representatives and the President Pro Tempore of the Senate, the Governor of the State, and two by a majority vote of the other members.

Section 6(a)(3) of SB81 authorizes and empowers the Authority to “[p]urchase, acquire, develop, establish, construct, own, control, lease, equip, improve, administer, maintain, operate, and/or regulate airports and/or landing fields for the use of airplanes and other aircraft and all facilities incidental thereto, within the limits of Mecklenburg County; and for any of such purposes, purchase, acquire, own, develop, hold, lease, sublease, and operate real and/or personal property.”

Section 7(a) of SB81 authorizes the Authority to acquire real and personal property from the City and Mecklenburg County, by agreement with them, and the City and County are authorized to grant and convey real and personal property. Section 7(b) of SB81 requires the City to transfer to the Authority all of its right, title, and interest to the airport within 90 days after enactment of SB81 or, if federal agency or current bondholder approval is required, within 90 days after those approvals are obtained. Further, the transfer required by Section 7(b) “includes all liabilities, leases, licenses, options to purchase, and other encumbrances on the airport property.”

These provisions, together and in conjunction with other provisions of SB81, effectively make the Authority the successor owner and operator of the airport and the entity responsible for carrying out the City’s duties and obligations in relation to the airport.

Airport Revenue Bonds

It appears from a Summary of Outstanding Debt as of June 30, 2012 furnished to us that the City had outstanding as of that date \$684,890,000 of airport revenue bonds and \$175,205,000 of special facility revenue bonds, for a total of \$860,095,000, financing various airport facilities. We have been advised that the City previously issued general obligation bonds to finance airport facilities, but that none currently are outstanding.

The airport revenue bonds were issued pursuant to a Bond Order adopted by the City Council on November 18, 1985, a First Supplemental Bond Order adopted by the City Council on June 8, 1992, and a Second Supplemental Bond Order adopted by the City Council on August 23, 2004, authorizing and securing all airport revenue bonds (collectively, the “Bond Order”), and in the case of each series of bonds a separate resolution or resolutions providing for their details and other matters (the “Series Resolutions”). We understand that the Bond Order had not been amended as of at least February 10, 2010, and have not been advised that the Bond Order has been further amended and assume that it has not. In addition, we have examined the Series Resolutions relating to the Series 2010A, B and C Bonds and with your permission have assumed that they have not been amended and that the resolutions for other series of airport revenue bonds are not materially different for purposes of this letter.

Successor Entity

The Bond Order contemplates that at some point, there might be a successor to the City in connection with the airport and duties and obligations imposed by the Bond Order, and includes a provision making provision for that eventuality:

“Section 1301. Effect of Covenants. All covenants, stipulations, obligations and agreements of the City contained in this Order . . . shall bind or inure to the benefit of the successor or successors thereof from time to time and any officer, board, body or commission to whom or to which any power or duty affecting such covenants, stipulations, obligations and agreements is transferred by or in accordance with law.

Except as otherwise provided in this Order, all rights, powers and privileges conferred and duties and liabilities imposed upon the City by the provisions of this Order shall be exercised or performed by the City Council, or by such other officer, board, body or commission as may be required by law to exercise such powers or to perform such duties.”

This provision applies to a successor to the City, but SB81 does not create a successor to the City. It also applies to an “officer, board, body or commission to whom or to which” duties and obligations are transferred, but does not further describe the possible transferees, and it is not clear whether this contemplates a City administrative reorganization or an entity created by the General Assembly or both. Those persons and entities as described in Section 1301 would be compatible with continued City ownership and continued City operation via a different organizational structure. The Authority may be a board or body within the contemplation of Section 1301, but that section does not refer to other entities, such as other political subdivisions or authorities, which are more explicitly outside the orbit of the City. In Continental Illinois National Bank and Trust Company of Chicago v. The Illinois State Toll Highway Commission et al.,¹ the Illinois Supreme Court considered a transfer of property, functions and powers from a Toll Highway Commission to a State Toll Highway Authority:

“It is argued . . . that the transfer of assets from the Commission to the Authority impairs the bondholders’ contractual rights, because the bond resolution prohibits such a transfer. However, an examination of the resolution discloses that it expressly contemplates and considers the succession of a governing body such as the Authority. Resolution section 1.01(g) specifies that: “‘Commission’ means the Illinois State Toll Highway Commission . . . and any successor or successors, including any . . . authority . . . , who may be authorized to construct, operate or maintain the Toll Highway.” Further, section 12.03 of the resolution declares that whenever the Commission is named or referred to in the resolution, such reference shall be deemed to include the successors or assigns thereof, and all the covenants and agreements in this Resolution contained by or on behalf of the Commission shall bind and inure to the benefit of the respective successors and assigns thereof whether so expressed or not. Nothing appears in the resolution

¹ 251 N.E.2d 253 (Ill. 1969)

concerning the composition or structure of the governing authority which would restrict government to the Commission.” (Emphasis added.)

Section 1301 does not affirmatively authorize any transfer, and only specifies what should happen if a transfer should occur. Accordingly, a transfer of duties and obligations as contemplated by SB81 is not expressly authorized by Section 1301, or for that matter by any other provision in the Bond Order, and no violation of Section 1301 *per se* would occur as a result of the transfer. However, because what is involved here is a State-mandated transfer, this raises the issue of whether the enactment of SB81 by the State otherwise constitutes an impermissible impairment of bondholder rights under the Contract Clause.

The Contract Clause of the U.S. Constitution² states that “[n]o state shall . . . pass any . . . law impairing the obligation of contracts[.]” The Supreme Court of North Carolina has said that “[i]n determining whether a contractual right has been unconstitutionally impaired, we are guided by the three-part test set forth in U.S. Trust Co. of N.Y. v. New Jersey, 431 U.S. 1, 97 S.Ct. 1505, 52 L.Ed.2d 92 (1977). The U.S. Trust test requires a court to ascertain: (1) whether a contractual obligation is present; (2) whether the state’s actions impaired that contract, and (3) whether the impairment was reasonable and necessary to serve an important public purpose.”³

Determinations of whether a proposed course of action would satisfy the three-pronged U.S. Trust standards are highly fact-specific, and in the absence of a North Carolina court having decided similar matters, we cannot predict how North Carolina courts would come out on these issues. Cases from other jurisdictions are not controlling, and in any event involve factual underpinnings that may not be the same or similar enough to those presented here.

It can be argued that the transfer of duties and obligations, whether or not Section 1301 is deemed to apply and in any event considering that no substantive obligations are changed under the Bond Order,⁴ would not be deemed to be significant enough to constitute an impairment within the contemplation of the Contract Clause. The transfer of governing control of an airport from a county to an airport authority was at issue in Wayne County Board of Commissioners v. Wayne County Airport Authority,⁵ and was permitted. The county had complained that the transfer of operational jurisdiction from the county to the airport authority is “directly contrary to the express contractual commitment made by the county to . . . existing bondholders.”⁶ The court was not convinced: “The pledge not to transfer airport property was meant to ensure that assets necessary to generate the revenue remain dedicated to that purpose. That fact has not changed: the airport property will remain subject to airport purposes and the revenue will continue to fund the bonds. Plaintiffs simply have not shown that the bondholders have a

² U.S. Const. Art. I, § 10.

³ Bailey v. State of North Carolina, 348 N.C. 130, 140-141, 500 S.E.2d 54, 60 (1998).

⁴ As one very important example, the property providing security for the bonds remains unaffected. Section 701 of the Bond Order provides that “[t]he Bonds are special obligations payable solely from the Net Revenues, the City’s rights to receive the same, and money and Investment Obligations held in the Funds, Accounts and subaccounts created hereunder, other than the Airport Discretionary Fund and the income from such Investment Obligations and the investment of such money.”

⁵ 658 N.W.2d 804 (Mich. Ct. App. 2002)

⁶ *Id.* at 820 above

contractual entitlement to retain the commission as the airport manager, as distinguished from a new agency controlled by the board as set forth by the statute.”⁷

The impetus for the transfer in Wayne County Board of Supervisors was allegations in the 1990’s of Wayne County mismanagement of the Detroit Metropolitan Airport and another airport, which were being operated by the County. These allegations were, according to the court, the subject of a 200 page report of a joint committee created by the State Legislature identifying general problems in a number of areas. These allegations and the State Legislature’s response, as well as the County’s own concessions regarding the subject, proved to be important elements in the result of this case. Regarding that concession, the County had stated in its motion: “The [] audits [prompted by the commission] . . . revealed a pattern of mismanagement and corrupt practices [at Metro].”⁸ News reports alleging instances of mismanagement by the airport director and/or staff in the operation of the Charlotte airport, and of admissions of their supervisors at the City and corrective action taken by the City relating to them, have been brought to our attention, but we cannot predict what import North Carolina courts would give them. On just the face of the news accounts, the facts at hand can be distinguished from those of the Michigan case. In addition, we cannot predict whether North Carolina courts would follow the same rationale as the Michigan courts did.

It is also possible that bondholders could make assertions not made in Wayne County Board of Supervisors, based on particular facts and circumstances that may be present.⁹ For example, bondholders could assert an expectation, even if it is not a legal obligation, that the City would support the airport, as a City enterprise, if it encounters financial or other difficulty, whether based on past practice or otherwise, whereas other members of the Authority may not be willing or able to do so. In addition, it is possible that, based on facts and circumstances, bondholders could assert that the governance structure of the Authority or other factors render the Authority unable, as a *practical* matter, to discharge its assumed duties and obligations under the Bond Order. Such factors might include, among other things, the ability to expand the airport by eminent domain if necessary,¹⁰ whether adequate provision can be made, if necessary, for fire and police protection, and the like.

Courts in other jurisdictions have found governance issues to be important. For example, in Patterson v. Carey,¹¹ involving a statute rescinding a toll increase imposed by a toll road authority, requiring that the authority submit justification for any toll increase to the State Comptroller prior to the effective date of any increase and also requiring public hearings on any increase, the court held these actions to be violations of the Contract Clause of the U.S. Constitution:

“In this case, the State granted to the authority the power to increase the toll on the Southern State Parkway and pledged not to limit or alter the rights vested in the authority to the detriment of the bondholders Since the toll is the sole source of funds for bond repayment, any limitation on the authority’s power to

⁷ *Id.*

⁸ *Id.* at 819 n.30.

⁹ Bondholders were not parties to Wayne County Board of Supervisors.

¹⁰ Section 7(c) of SB81 imposes restrictions on the ability of the Authority to exercise powers of eminent domain, e.g., concurrence by a majority of members of the Authority, not only the City.

¹¹ 363 N.E.2d 1146 (N.Y. 1977)

collect a toll sufficient to pay the bonds deprives the bondholders of an essential attribute of their contract with the authority and with the State and jeopardizes their investment. The statute under consideration suspends a toll increase imposed by the authority and conditions any future increases upon compliance with a complicated and time-consuming procedure. Bondholders were promised, as part of the arrangement which financed the reconstruction of the highway, that the authority could raise the toll if the authority, in its discretion, deemed an increase necessary to pay its operating expenses and meet its bond obligations. With the present statute, the Legislature has diminished the bondholders' rights by suspending one increase and *limiting the authority's previously broad discretion to impose future increases*. Thus, the statute has deprived the bondholders of a right granted by their contract with the authority and the State."¹² (Emphasis added.)

No North Carolina cases dealing with these issues have come to our attention and we cannot predict whether a North Carolina court would apply the same reasoning as the New York courts in applying assertions such as those described above, or other assertions.

Property Transfer

The City has covenanted with the holders of its airport revenue bonds, by Section 713 of the Bond Order, to expressly limit the circumstances under which certain airport property may be disposed of. Authority for this provision can be found in several statutes permitting the City to dispose of airport property,¹³ dispose of it to another governmental unit,¹⁴ and sell city-owned enterprises, in the case of airports, without voter approval,¹⁵ and to covenant with revenue bondholders with regard to the disposition of property for revenue bond projects.¹⁶

It is doubtful that the conditions of Section 713 can be met if the City itself is required to comply with them in the context of a transfer of property and control of the airport to the Authority as contemplated by SB81. It could be argued that the State, by enacting SB81, would thus be causing the City to violate Section 713 by causing a disposition of property in violation of the provisions of that section.¹⁷ This has the potential to cause an "Event of Default" to occur under paragraph (g) of Section 802 of the Bond Order.¹⁸

In addition, because the State is compelling the transfer, an additional issue is whether the transfer constitutes an impermissible impairment under the Contract Clause. Similar issues have been raised elsewhere and decided in favor of the transfer. See, e.g., Continental Illinois, *supra*.

¹² *Id.* at 1152-53.

¹³ N.C. Gen. Stat. § 160A-265 (2012).

¹⁴ *Id.* at § 160A-274.

¹⁵ *Id.* at § 160A-321.

¹⁶ *Id.* at § 159-89(iv).

¹⁷ Similarly, there are many other provisions of the Bond Order that require City action, including the rate covenant of Section 704, and these provisions also would be implicated in much the same way.

¹⁸ It is an "Event of Default" under the Bond Order if, among other things, "(g) the City defaults in the due and punctual performance of any other of the covenants, conditions, agreements and provisions contained in the Bonds or in this Order, and such default continues for 30 days after receipt by the City of a written notice from the Trustee specifying such default and requesting that it be corrected, provided that if prior to the expiration of such 30-day period the City institutes action reasonably designed to cure such default, no "Event of Default" shall be deemed to have occurred upon the expiration of such 30-day period for so long as the City pursues such curative action with reasonable diligence."

See, also, Wayne County Board of Commissioners, *supra*, where the court held that the transfer there constituted a minimal impairment (and therefore was permissible) because both the liability under the bonds and the revenue securing them were transferred. However, no North Carolina cases have come to our attention addressing these issues in the full context presented here and, accordingly, we cannot predict the outcome should this be contested.

Agreement of State

An additional consideration is GS § 159-93,¹⁹ an agreement of the State with holders of revenue bonds such as the airport revenue bonds:

“The State of North Carolina does pledge to and agree with the holders of any revenue bonds or revenue bond anticipation notes heretofore or hereafter issued by the State or any municipality in this State that so long as any such bonds or notes are outstanding and unpaid the State will not limit or alter the rights vested in the State or the municipality at the time of issuance of the bonds or notes to establish, maintain, revise, charge, and collect such rates, fees, rentals, tolls, and other charges for the use, services, facilities, and commodities of or furnished by the revenue bond project in connection with which the bonds or notes, or bonds or notes refunded by the bonds or notes, were issued as shall produce revenues at least sufficient with other available funds to meet the expense of maintenance and operation of and renewal and replacements to such project, including reserves therefor, to pay when due the principal, interest, and redemption premiums (if any) of the bonds or notes, and to fulfill the terms of any agreements made with the bondholders or noteholders, nor will the State in any way impair the rights and remedies of the bondholders or noteholders until the bonds or notes and all costs and expenses in connection with any action or proceedings by or on behalf of the bondholders or noteholders, are fully paid, met, and discharged.”

This provision is relevant because, among other things, Section 704 of the Bond Order contains a rate covenant that obligates the City, among other things, to “fix, charge and collect rates, fees, rentals and charges for the use of the Airport and shall revise such rates, fees, rentals and charges as often as may be necessary or appropriate to produce Revenues in each Fiscal Year at least equal to” the amounts needed to pay current expenses and debt service and maintain debt service and renewal and improvement reserves, and other provisions of the Bond Order require the City to perform other specific functions. There does not appear to be any attempt in SB81 to affect any of these provisions *per se*. Accordingly, one way to approach this provision, as with the succession and disposition of property issues discussed above, is that because the security for the bonds is not affected and only the entity responsible for administering that security is being changed, then Section 159-93 is not being violated, or at least is not being violated to an impermissible degree under a Contract Clause analysis. However, unlike the Bond Order, Section 159-93 contains no provision for a successor “municipality,” and thus can be read to prohibit any change that prevents the original municipality from performing its obligations and the right of bondholders to enforce these provisions against the original municipality. In this context, SB81 can be viewed as both a violation of the State’s agreement with the bondholders

¹⁹ N.C. Gen. Stat. § 159-93 (2012).

and a possible impermissible impairment of the contract between the State and the bondholders pursuant to the Contract Clause. No North Carolina cases have come to our attention which construe this Section or which address whether, under these circumstances, the State would be violating its agreement with the bondholders by enacting and implementing SB81 or SB81 would impermissibly impair the State's contract with bondholders.

Amendment and Refunding

If in fact the enactment of SB81 constitutes an unconstitutional impairment, obtaining the consents of at least 51% in principal amount of the outstanding bondholders for appropriate amendments of the Bond Order or the refunding and defeasance of all of the outstanding bonds would provide legal alternatives insofar as bondholders (but not other parties) are concerned. Our experience has been that consents often are difficult to obtain, depending on the facts and circumstances involved. However, we are not financial advisors and express no view or as to the likelihood of obtaining such consents if needed or as to the cost or feasibility of any refunding.

We point out in regard to any such amendments that the Reimbursement and Security Agreements between the City and Bank of America, N.A., as Credit Provider, relating to the Variable Rate Airport Revenue Bonds, Series 2007B, Series 2008D, Series 2010C and Series 2011C, require the prior written consent of the Credit Provider to any amendments to, among other things, the Bond Order. We have been advised that Ambac Assurance Corporation has insured the Airport Revenue and Refunding Revenue Bonds, Series 2007A, and note that Ambac consent is required in connection with any amendment of the Bond Order, in addition to bondholders' consents. We express no view as to whether either entity would consent to an amendment of the Bond Order.

Federal Tax Exemption of Interest

The interest on most of the outstanding bonds is excluded from Federal income taxation. Some of the outstanding bonds cannot be refunded at this time because of Federal tax law restrictions on advance refundings (*i.e.*, refundings in advance of 90 days prior to retirement of the bonds being refunded). We do not see the assumption of liabilities proposed by SB81 as causing a refunding, nor do we see the proposed transaction causing a reissuance of debt for tax purposes that would result in adverse consequences.²⁰

Other Agreements

We have not reviewed other agreements that the City has with various parties, such as airport agreements and leases, special facility leases, special facility bond orders and indentures, concessionaire agreements and the like. To the extent that those agreements are essential to the operation of the airport and for one reason or another cannot be assigned or otherwise transferred, that possibly could have an effect on the transfers of property, duties and obligations from the City to the Authority and whether they constitute an impermissible impairment under the Contract Clause.

²⁰ See, Internal Revenue Service Office of Chief Counsel Memorandum Number AM 2012-004 Released 6/1/2012 (relating to the dissolution of California Redevelopment Agencies and successor agencies).

Conclusion

As more fully discussed above, whether SB81 would cause an impermissible impairment of bondholder rights under the Contract Clause of the U.S. Constitution or constitute the basis for an Event of Default under the Bond Order or violation by the State of statutory covenants is uncertain, given the absence of controlling North Carolina judicial precedent, differences in facts presented in cases decided in other jurisdictions and those present in this case, and unknown facts and circumstances, although reasonable arguments can be made in support. Insofar as bondholders (but not other parties) are concerned, bondholder consents and defeasances of outstanding bonds provide potential resolutions to these issues. In addition, there may be other significant issues that should be considered which could pose obstacles to the implementation of SB81.

Very truly yours,



Steven I. Turner