

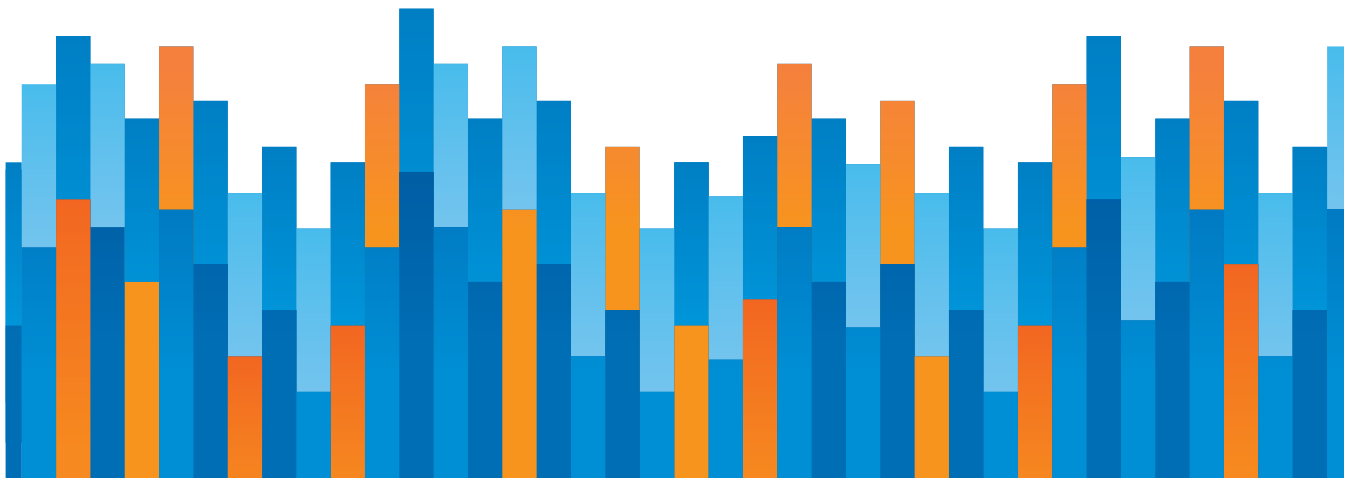


# **METRO'S 28 BY 2028 PLAN: A CRITICAL REVIEW**

## **XIII. METRO HAS A HISTORY OF EVADING LEGAL REQUIREMENTS, POTENTIALLY IGNORING THE LAW**

By Thomas A. Rubin, CPA, CMA, CMC, CIA, CGFM, CFM and  
James E. Moore, II, Ph.D.

May 2019



## XIII. METRO HAS A HISTORY OF EVADING LEGAL REQUIREMENTS, POTENTIALLY IGNORNING THE LAW

The Los Angeles County Metropolitan Transportation Authority (Metro) was created by an act of the California Legislature,<sup>1</sup> but it and its predecessor agency have a history of using innovative and sometimes questionable legal interpretations to accomplish agency objectives. Some of the most prominent examples follow.

### USE OF PROPOSITION C TRANSIT SALES TAXES FOR HIGH OCCUPANCY FREEWAY LANES AND OTHER ROAD IMPROVEMENTS

In 1980 Proposition A, the first Los Angeles County transit sales tax, included a map with 11 rail lines that were to be constructed with these funds. After passage, the Los Angeles County Transportation Commission (LACTC), the planning and funding predecessor of Metro, began a major program of rail transit planning, design and construction. However, by the late 1980s, LACTC realized that it had already over-reached in attempts to build the first three lines—the Blue, Red, and Green lines. With insufficient funding to proceed, the LACTC leadership decided to propose a second sales tax, which eventually became 1990's Proposition C.

Polling results showed a problem. The taxpayers were unlikely to pass such a proposition, even with the lower 50%+1 majority that was required for new taxes at the time. However, the same polling data revealed that the voters would be more favorable to such a proposition if it included road funding.

This presented another problem. The California Public Utilities Code (PUC) §130350 *et seq*, allowed LACTC to place a sales tax proposal before the voters, but was subject to the restrictions of PUC §130354:

*The revenues received by the Los Angeles County Transportation Commission from the imposition of the transaction and use taxes shall be used for public transit purposes.*

This plain language left LACTC with two options: (1) find other means to get a transportation sales tax with a road provision before the voters, since LACTC did not have statutory authority to do so, or (2) find a way to get roads classified as transit. LACTC tried both avenues, first attempting to persuade

---

<sup>1</sup> Los Angeles County Metropolitan Transportation Authority Reform Act of 1992 (AB152, Katz).

a super majority of the various Los Angeles County cities or the county, which LACTC believed had the authority to place such a tax on the ballot, to pass resolutions doing so. These efforts failed.

The second avenue led to another obstacle, specifically the court decision in *City of El Cajon et al v. Lonergan*.<sup>2</sup> In *El Cajon*, the city wanted to use Transportation Development Act of 1971 (TDA) sales tax funds, which were enacted for public transit purposes, for improving public roads. Gerald Lonergan, the San Diego County Auditor, refused to authorize the disbursement, resulting in the legal action. Part of the city's argument was that the road use of transit funds had been authorized by the Comprehensive Planning Organization of the San Diego Region (CPO), which was essentially the San Diego County equivalent of LACTC. The court found, however:

*Finally, there is no merit in El Cajon's contention that the allocation by the CPO can be sustained under its rule making authority. CPO has no authority contrary to the statute.*

A share of the revenue from each of Metro's four sales taxes is returned directly to Los Angeles County cities for transit projects. LACTC was well aware of this case law, because some L.A. County cities had attempted to use their own Proposition A local return funds for road maintenance, arguing that, since buses traveled on the roads they proposed to fund, fixing that road was a transit use. LACTC did not want to allow this, and its special counsel advised the agency that such a use was not allowed, citing the *El Cajon* decision.<sup>3</sup>

However, after failing to persuade the county and the cities to put a sales tax measure that included road uses on the ballot, LACTC's only viable option was to have the Commission do so. This required an artful change of position, which LACTC staff provided at the last board meeting at which action could be taken to place the measure on the November 1990 ballot. The measure included a very carefully written definition:

*Twenty-five percent of the revenue from the ½ cent sales and use tax will be used to provide essential County-wide transit-related improvements to freeways and State highways.*

After Proposition C made it onto the ballot and was passed by the voters, LACTC immediately began planning and constructing high occupancy toll lanes by widening county freeways. The vast majority of these facilities had very little transit use. After Metro came into existence, it somehow further broadened the interpretation of "transit-related improvements" to include \$218.7 million of Proposition C 25% funds for the Alameda Corridor, the below-grade freight rail line from the Ports of Los Angeles and Long Beach to transfer facilities east of the Los Angeles central business district.<sup>4</sup>

---

<sup>2</sup> 1978, 83 Cal.App.3d 672.

<sup>3</sup> Nossaman, Guthner, Know & Elliot. Letter to Rick Richmond, Executive Director, LACTC, January 25, 1984. Bates numbers M 339 077/88 in *Labor/Community Strategy Center v. MTA*.

<sup>4</sup> Alameda Corridor Program – MTA Funding Agreement, September 26, 1997.

(This allocation was later reduced to \$48.7 million after a change in state statute allowed Metro to use other funds for part of this cost.)

## **FUNDING THE GOLDLINE EASTSIDE SUBWAY WITH SALES TAX FUNDS PROHIBITED FROM USE FOR SUBWAY CONSTRUCTION**

In the environmental clearance document for the Gold Line Eastside light rail project, Metro presented a series of alternatives for the Gold Line Eastside that included subway sections. Metro's Locally Preferred Alternative included approximately two miles of subway and two subway stations out of the total of eight—and \$52.4 million of Proposition A 35% Rail Construction funding.<sup>5</sup> However, in the same document, Metro explained that,<sup>6</sup>

*A 1998 ballot initiative sponsored by County Supervisor Zev Yaroslavsky, referred to as the Metropolitan Transportation Authority Reform and Accountability Act, was approved (and became effective) on November 3, 1998. The most significant provision of the new law stipulates that no local Proposition A or C sales tax monies will be used to fund the planning, design, construction, or operation of any New Subway. The term "New Subway" is defined to mean any subway project (a rail line which is in a tunnel below grade) other than the Metro Red Line Segments 1, 2 or 3 (North Hollywood). As a result, the initiative prohibits the use of these sales tax revenues to build subway extensions in the Eastside or Mid-City/Westside corridors.*

How, after acknowledging ballot language that "...prohibits the use of these sales tax revenues to build subway extensions in the Eastside ... corridor(s)," did Metro reconcile the contradiction between this legal requirement and the way that agency decided to use restricted funds on a subway project? Metro argued that the no-subway sales tax funds were used only for construction of the *non-subway* portions of the line, and that the subway segment was funded by revenue from non-restricted sources.

## **CAPITALIZED INTEREST DURING CONSTRUCTION**

Capitalized interest during construction is an accounting concept. The cost of debt to get capital assets ready, particularly assets that can require years to be constructed, is a cost of the asset and should be treated as such. This principle was first formalized into Generally Accepted Accounting

---

<sup>5</sup> Ibid. Table S-10. "Proposed Funding Sources and Amount for Eastside LRT Project." S-57.

<sup>6</sup> Metro. *Gold Line Eastside Light Rail Project, Final Environment Impact Statement/Final Environmental Impact Report*. Executive Summary. S-9.

[http://media.metro.net/projects\\_studies/eastside/images/Executive%20Summary.pdf](http://media.metro.net/projects_studies/eastside/images/Executive%20Summary.pdf)

Principles (GAAP) in 1979.<sup>7</sup> However, even before this standard became GAAP, it was statute in California, listed in an Act that literally has LACTC's name on it:<sup>8</sup>

*Cost ... means all or any part of the cost of construction and acquisition of all real or personal property, ... **interest prior to, during, and for a period after completion of construction as determined by the commission** ... (emphasis added)*

However, neither LACTC, nor later Metro, included capitalized interest in the costs of its projects. In fairness, most other transit agencies in the U.S. also ignored this requirement, but Metro is the only one that was required to comply with this accounting standard by state statute.

## METRO'S USE OF MEASURE R "NON-SUPLANT" BUS FUNDS TO SUPPLANT OTHER REVENUES

In 2008, Metro had to receive authority from the state legislature to ask the voters for what became Metro's third half-cent county transportation sales tax: Measure R. This authority came in the form of AB2321 (Feuer, 2008). While this bill was proceeding through the legislative process, legislators who were familiar with Metro's history of favoring rail construction over bus operations added language to the bill requiring that part of the funding provided by the new sales tax be dedicated to bus operations only, and that these new bus funds couldn't be utilized by Metro to replace Metro's bus allocations from existing sources. This resulted in a Senate amendment to add this protection, which was codified as PUC§130350.5(b)(3):

*The MTA shall, during the period in which the ordinance is operative, allocate 20 percent of all net revenues derived from the tax for bus operations to all eligible and included municipal transit operators in the County of Los Angeles and to the MTA, in accordance with Section 99285. ... **Funds allocated by MTA to itself pursuant to this section shall be used for transit operations and shall not supplant funds from any other source allocated by MTA to itself for public transit operations.** (emphasis added)*

The legislative history provides further clarification:<sup>9</sup>

*Senate Floor Amendments of 8/22/08 ensure that existing funds allocated by the Los Angeles County Metropolitan Transportation Authority to itself and other transit operators in Los Angeles County will not be displaced by revenue authorized by this bill.*

---

<sup>7</sup> Financial Accounting Standards Board. "Summary of Statement No. 34, Capitalization in Interest Costs." <https://www.fasb.org/summary/stsum34.shtml>

<sup>8</sup> Los Angeles County Transportation Commission Revenue Bond Act, codified as PUC §130513.

<sup>9</sup> "Analysis." "Senate Floor." 08/25/08. 2, 5. [http://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill\\_id=200720080AB2321](http://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=200720080AB2321)

*8. Specifies that 20 percent of all net revenue derived from the tax is for bus transit operations to all eligible and included municipal transit operators in Los Angeles County and the MTA. However, all allocations to the MTA and eligible and included municipal operators shall be made solely from revenues derived from a tax imposed pursuant to this section, and not from local discretionary sources.*

*9. Prohibits MTA from displacing the existing revenue that it allocates with revenue from the sales tax authorized by this bill. In addition, the bill requires that the existing revenues that MTA allocates to itself be used for transit operations.*

As is inevitably the case with new requirements, some interpretation is required. The following two interpretations apply here:

1. To determine what is required for Metro to observe the “supplantation” or “displacement” prohibitions, there must be a standard to refer to, a starting point. AB2321 was working its way through the legislature during the summer of 2008, and was approved by the governor and chaptered into law on September 25, 2008,<sup>10</sup> approximately three months into Metro Fiscal Year 2008-2009 (FY09). If Measure R was approved by the voters, the first full year of tax receipts would be the following year, Metro FY10. It is reasonable to use FY09 as the bus funding allocation base year for applying the non-supplantation/displacement test.
2. There is no discussion of adjustment for inflation in the Act or the legislative history, but without such an adjustment the protection AB2321 is intended to afford would become meaningless. Over time, the spending power of the prior allocations would have to be nominally increased as inflation made the dollars less valuable. As it turns out, the question of inflation adjustment does not impact Metro’s compliance or non-compliance with this requirement, only the magnitude of Metro’s non-compliance.

It was possible to do a detailed analysis of Metro’s budgeted spending on its bus services for the years FY09 through FY17. Metro significantly reduced the amount of detail in its *Adopted Budgets* for FY18, and the same level of analysis is no longer possible.

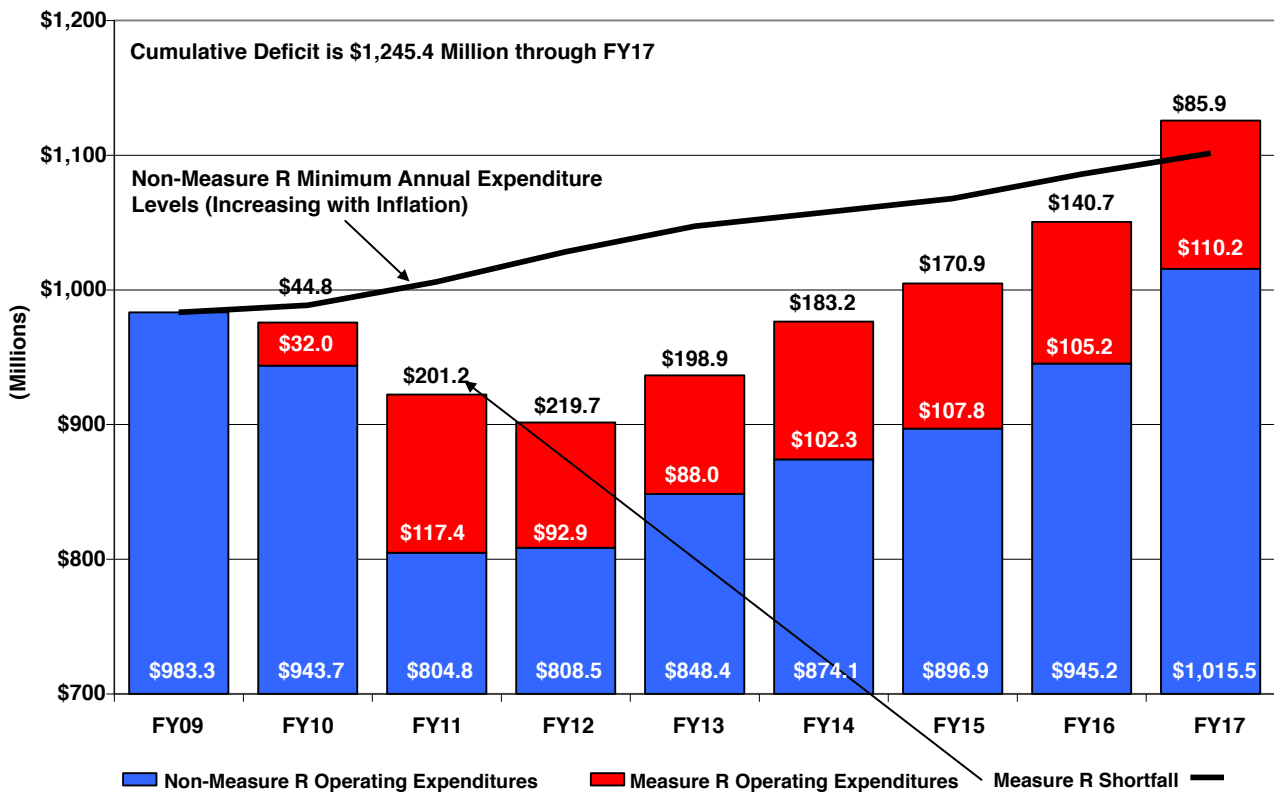
The economic downturn began before Measure R even became law, and Metro found itself in a familiar situation—without the funds needed to proceed with the rail construction it had started. Metro responded as it had in the past, which included reducing spending on bus operations. **Figure 1** shows that, instead of following the non-supplant dictate, Metro used the new Measure R funds to

---

<sup>10</sup> California State Legislature. AB-2321 Bill History.  
[http://leginfo.legislature.ca.gov/faces/billHistoryClient.xhtml?bill\\_id=200720080AB2321](http://leginfo.legislature.ca.gov/faces/billHistoryClient.xhtml?bill_id=200720080AB2321)

make up part of the shortfall relative to pre-FY09 bus funding. To remain compliant with AB2321, the blue bars would have to reach the line of inflation-adjusted expenditures. Instead, the red Measure R funds are replacing some of the funds Metro shifted away from bus operations. From FY10 through FY17, the cumulative shortfall is almost one-and-one-quarter billion dollars. Without adjusting for inflation, the shortfall is a mere \$729.1 million, net of \$32.2 million in payback in FY17 when the unadjusted bus funding finally began to exceed the inflation-adjusted FY09 baseline.

**Figure 1: Los Angeles County Metropolitan Transportation Authority  
Non-Measure R/Measure R Bus Budgeted Operating Spending FY09-FY17 (Inflation-Adjusted)**



Source: Los Angeles County Metropolitan Transportation Authority. , *Adopted Budgets*, FY09-FY17, inclusive, and U.S. Bureau of Labor Statistics.

## CONCLUSIONS

1. Transit is a complex institutional environment, and Metro’s actions must comply with multiple statutory, regulatory, case law, contractual and other legal requirements.
2. When Metro encounters potential legal restrictions, at times the agency works to circumvent them. Metro can be very innovative in finding ways to build and operate the service that it most wants to deliver, even at high opportunity cost.