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New Professional Sports Arenas: A Game Plan to Prepare for and Overcome a Myriad of Legal and Regulatory Challenges

by

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New Professional Sports Arenas: A Game Plan to Prepare for and Overcome a Myriad of Legal and Regulatory Challenges

Cities, counties and private businesses throughout the U.S. are competing to retain and recruit professional sports teams. The decisive strategy in nearly every playbook is the promise of a new arena – multi-million dollar projects that generate a multitude of lawsuits from opposition groups that are determined to delay if not derail these projects, especially those that involve public funding. New arena sponsors are asking the same question – what offensive and defensive positions are needed to win the arena game?

In August 2015, the City of Sacramento and the Sacramento Kings NBA team beat the last legal challenge to the Kings' new $477 million downtown home, ending years of legal and regulatory battles. The public-private partnership behind the arena overcame every litigation targeting the planning, approval, environmental review, financing and construction of the arena. The City's experience covered a myriad of expected and unexpected complications, including fighting a ballot measure to force a public vote, constitutional challenges to new state legislation, attacks on environmental approvals, disputes about the eminent domain process, alleged violations of bond financing statutes, and a trial at which the Mayor and the Kings' majority owner took the stand to face allegations of a "secret subsidy," fraud, concealment, collusion, waste and illegal expenditure of public funds. Sacramento's new Golden One Arena project presents a valuable roadmap for public and private entities involved in delivering new professional sports arenas.

Kings' Arena Background

In January 2013, the City of Sacramento learned that the owner of the Kings NBA franchise agreed to sell the team to a new owner who intended to relocate the team to Seattle. The City urgently put in place a multi-faceted effort to keep the Kings in Sacramento, including assembling investors who ultimately purchased the team. During the next 16 months, the investors negotiated agreements with the City to jointly fund a new multi-purpose entertainment and sports center in downtown Sacramento that would serve as the Kings' new home.

The NBA set a fast-track timeline for the new arena, requiring negotiation of agreements, site acquisition, completion of environmental review and construction to be completed in 2016. In early 2014, the site was acquired through eminent domain. In mid-2014, California Environmental Quality Act (CEQA) review was completed and all agreements for the project were executed. The City agreed to contribute $255 million toward construction of the arena, gave the Kings' owners the right to build up to six digital billboards and agreed on a management contract for the Kings to operate and maintain a City-owned parking structure. In exchange, the Kings agreed to pay the balance of construction costs and any cost overruns; purchase the site; develop, operate and maintain the arena during a 35-year lease; and make lease payments to the City.

Environmental Review/Approval Litigation

In what is becoming standard practice, opponents to the Kings' arena attacked environmental approvals, but numerous novel legal issues arose. To meet the NBA's schedule, the City of Sacramento made a game-changing move, seeking help from the state legislature to streamline the traditionally lengthy environmental and judicial review process under the California Environmental Quality Act (CEQA). The resulting statute (SB 743, Public Resources Code section 21168.6.6), allowed specific stadium activities to move forward while CEQA review was being completed and narrowed the grounds and available remedies in CEQA lawsuits. The legislation reduced the usual CEQA timelines and created important protections for the project, such as allowing property to be acquired by eminent domain prior to CEQA; requiring certification of the administrative record soon after project approval; heightening the standard for an injunction to halt the project; and mandating that CEQA litigation (including appeal) be resolved within 270 days, if feasible. While these provisions gave the City a degree of certainty for the project, they also required the City to compile the record during the review process and be prepared to defend its CEQA process in court immediately after project approval.

The Sacramento City Council approved the project based on an environmental report prepared in accordance with the special statute. Opponents challenged the constitutionality of SB 743's expedited review and injunction provisions, as well as the City's substantive findings under CEQA. Two Court of Appeal decisions upheld the new statute and the City approval process. The first decision rejected a claim that the legislation was unconstitutional based on the separation of powers doctrine relating to limits on timing and grounds for judicial review, finding that the streamlining and other provisions did not interfere with the court's inherent powers. (*Saltonstall v. City of Sacramento*, 231 Cal. App. 4th 837 (2014)).

Opponents also challenged the City's preliminary term sheet and the acquisition of the project site through eminent domain as violating CEQA because SB 743 allowed the City to exercise the power of eminent domain before completing the CEQA process. The second appellate decision rejected claims regarding the analysis in the environmental impact report and found that the City did not "pre-commit" to the project because it still had complete discretion to review the project, mitigate environmental impacts and even refuse to approve the arena. (*Saltonstall v. City of Sacramento* (2015) 234 Cal.App.4th 549) The success of the special legislation combined with two favorable appellate court decisions is encouraging to those who are looking to use Sacramento's special CEQA approval process as a model to pursue in other jurisdictions.

Eliminating or streamlining the CEQA process has become an important tool for demonstrating a city's ability to deliver a new stadium. Recent efforts by the California cities of Inglewood and Carson (to attract professional football teams) and Sacramento (retention of its professional basketball team) reveal two strategies for addressing CEQA obstacles – special legislation and the initiative process. While obtaining a CEQA exemption for an arena project is uncommon, special legislation to streamline and expedite CEQA review and/or avoid or reduce CEQA requirements for arena projects is becoming more prevalent. In addition to the Kings' arena-related statute (Public Resources Code section 21168.6.6), a new statute for constructing a NFL stadium in Los Angeles shortened the CEQA administrative process and judicial review in

exchange for carbon-neutral development and special measures to reduce traffic and air quality impacts (Public Resources Code Section 21168.6.5).

A second strategy for managing CEQA review in California is the initiative process. Voter-sponsored initiatives placed on the ballot in California have always been exempt from CEQA (14 Cal Code Regs Section 15378(b)(3)). However, in 2014, a unanimous state Supreme Court ruled that qualified voter initiatives adopted by a city council, rather than placed on the ballot, are also exempt from CEQA (*Tuolumne Jobs & Small Bus. Alliance v. Superior Court*, 59 Cal. 4th 1029 (2014)). The ruling settled an outstanding issue on the application of CEQA to council actions on initiatives. The court previously ruled that council-sponsored initiatives were subject to CEQA before being placed on the ballot. (*Friends of Sierra Madre v. City of Sierra Madre*, 25 Cal. 4th 165 (2001)).

In *Tuolumne Jobs*, the court created a different rule for initiatives that have qualified for the ballot through the voter signature process. When voter-sponsored initiatives are presented to the council, the council can adopt the initiative and exempt the project from CEQA review. *Tuolumne Jobs* creates the opportunity for arena sponsors to utilize the voter-sponsored initiative process to sidestep CEQA through council adoption instead of a vote by the people. This process has two advantages. It reduces delays and costs by (1) eliminating the arena project from CEQA review and (2) avoiding an election on the initiative. This approach is being used in the competition for a new football stadium by the Cities of Inglewood and Carson. In February 2015, the Inglewood City Council adopted a voter-qualified initiative authorizing the construction of a stadium as part of the Hollywood Park redevelopment plan. Since the council's adoption of the initiative is not subject to CEQA under *Tuolumne Jobs*, the construction process is expedited and the risk of delay due to CEQA processing and litigation is eliminated.

The City of Carson is potentially presented with the same process for the proposed stadium for both the Oakland Raiders and the San Diego Chargers. The joint stadium's proponents are preparing an initiative to circulate for voter signatures to qualify for the ballot. If the initiative qualifies, it will be presented to the Carson City Council to adopt or place on the ballot. Similar to Inglewood's experience, Carson stadium proponents hope the stadium initiative will be adopted by the City Council to avoid CEQA review and the election process. The resulting expediting of the stadium project will improve Carson's proposal. In the battle among suitors for professional teams, the sooner stadium construction can commence, the better. Opponents to the Sacramento Kings' arena initially attempted to overturn the City of Sacramento's decision by using the initiative process to require a public vote to fund sports arenas, but this effort failed because the initiative conflicted with the City's charter and did not comply with election laws.

Eminent Domain Litigation

The Sacramento Kings' arena also involved eminent domain litigation regarding a department store at a mall on the proposed arena site. The eminent domain action itself and, in particular, obtaining an Order for Prejudgment Possession in the eminent domain action within a short period of time, was critical in light of the NBA giving the Kings a short time period to secure a

site for a new arena. If the Kings did not accomplish this, then the NBA was expected to take over the Kings and likely allow the team to relocate to another city.

The City of Sacramento's eminent domain action and Motion for Order for Prejudgment Possession were vigorously opposed by the holder of a ground lease on the department store site, a bank as Trustee. The bank's counsel employed aggressive discovery tactics (voluminous document requests, many depositions), filed multiple motions seeking dismissal of the City's eminent domain action (including demurrers and motions to strike), and filed several briefs with both the trial court and the court of appeal to oppose the City's Motion for Prejudgment Possession. Ultimately, the court granted the City's Motion for Prejudgment Possession. Several months later, with the only remaining issue in the eminent domain action relating to the value of the property, the City was able to settle with the bank and the underlying owner of the property.

This was a unique eminent domain action. The general rule in eminent domain cases in California is that a public entity cannot exercise its eminent domain authority to acquire private property for a public use unless/until the public entity has gone through the environmental review process in compliance with the California Environmental Quality Act. In the Kings' arena situation, however, the California Legislature made a special exception for the arena project. In particular, the Legislature allowed the City to prosecute its eminent domain action up to the point of obtaining an Order for Prejudgment Possession prior to complying with CEQA. Once the City obtained its Order for Prejudgment Possession, however, the City was under a legal obligation to comply with CEQA. The court's rulings that the City complied with CEQA were critical. If the court had ruled against the City, the timing of the project would likely have been delayed and the project would have been in jeopardy.

"Secret Subsidy" and Public Financing Litigation

The final challenge to the Kings' arena involved taxpayers attacking the project agreements under common law and Code of Civil Procedure Section 526a, asserting claims of a "secret subsidy," fraud, illegality and waste of public funds. *(Gonzalez v. Johnson*, Sacramento Superior Court Case No. 34-2013-80001489) Such taxpayer claims require more than mistakes by public officials; they require an intent to deceive and misuse public funds for no public benefit that results in harm to the public.

While opponents frequently argue that an arena will not generate economic benefits, the scope of "public benefits" (i.e., public safety, civic pride, revitalization of a downtown area, retaining or increasing jobs, etc.) from such projects greatly exceeds "economic benefits" and is within the discretion of a municipality's governing body. The *Gonzalez* court's Proposed Statement of Decision noted that plaintiffs conceded that construction of the arena will provide some public benefits, but they disputed the extent of those benefits. While parties may disagree over the degree to which arenas generate economic activity, a taxpayer claim under Section 526a will fail so long as there are any public benefits from the public contribution. After a three-week trial with testimony from 18 witnesses, including the Mayor of Sacramento and the Kings' majority owner, the court found no merit to plaintiffs' "secret subsidy" allegations and ruled in favor of

the City on all claims. Less than one month later, the *Gonzalez* action was dismissed with prejudice, eliminating the possibility of appeal and ending the final legal hurdle to the arena.

While *Gonzalez* focused on claims of a "secret subsidy" relating to a public-private partnership agreement between the City of Sacramento and the owners of the Kings, the trial also addressed an area of unadjudicated law as plaintiffs' reverse validation claim challenged the City's finding that there is a "significant public benefit" from issuing bonds under the Marks-Roos Local Bond Pooling Act of 1985. The Validation Statutes (Govt. Code Section 860 et seq.) are procedural statutes designed to meet legislative goals for the speedy resolution of the validity of certain local agency actions, but the validity of any particular action, and the evidentiary standard, are based on the substantive law pursuant to which the action was taken. Prior to *Gonzalez*, there was little direction for cities in their issuance of bonds under the Marks-Roos Act.

The Marks-Roos Act requires the public entity issuing bonds to make a finding that there will be one of four "significant public benefits" from bond issuance. (Cal. Gov't Code § 6586) The Act describes a significant public benefit as any of the following: (a) demonstrable savings in effective interest rate, bond preparation, bond underwriting, or bond issuance costs, (b) significant reductions in effective user charges levied by a local agency, (c) employment benefits from undertaking the project in a timely fashion or (d) more efficient delivery of local agency services to residential and commercial development.

The City of Sacramento's bond resolution found that financing the City's share of the new arena with bonds issued under the Mark-Roos Act would produce significant public benefits including:

- The maintenance and promotion of economic development and increased employment within the City and the region.
- The improvement of the feasibility and enhancement of the development and redevelopment of the City's downtown core.
- The maintenance and generation of increased tax revenue to the City.
- The promotion of the general welfare, sense of community, and quality of life within the City and the region.
- The development of a multi-purpose entertainment and sports center to provide recreational and entertainment activities, amenities, and attractions to the people of the City and the region.
- The provision of a new facility for use by a National Basketball Association team as the primary user in order to assure the continued presence of professional basketball in the City and the region, and the beneficial and frequent media exposure and recognition that the continued presence of professional sports would bring to the City and the region.
- The demonstrable savings in effective interest rate and the costs of bond preparation, bond underwriting, and bond issuance that will result from financing the City's share of the Project through the Authority.

A public entity satisfies the required standard so long as the record includes the specific finding of the significant public benefit and support for that finding. A court reviews the administrative decision to determine if it is arbitrary, capricious, or entirely lacking in evidentiary support based on the evidence considered by the administrative agency. (*See American Board of Cosmetic Surgery v. Medical Board* (2008) 162 Cal.App.4th 534, 547.) Plaintiffs argued that their claim

should be based only on evidence presented at trial, not the record of the agency's decision, but the *Gonzalez* court disagreed. The Proposed Statement of Decision stated that the "evidence" considered by the court only includes the same evidence considered by the administrative agency, not evidence created after-the-fact, such as plaintiffs' expert testimony presented at trial. Plaintiffs further contended that the only relevant findings by the City were "employment benefits" and "demonstrable savings" and that those findings were not supported by the evidence. The judge disagreed.

> *Employment Benefits* - The judge cited the following items as sufficient evidence of employment benefits: (1) reports from City staff that the Arena could retain 800 jobs and create 2,000 - 6,000 new jobs, and generate $260 - $400 million in total economic output locally and nearly $1 billion regionally and statewide; and (2) information that the anticipated "ancillary development" could add more jobs and economic output. It is important to note that the judge found that plaintiffs' use of a different economic model "amounted to nothing more than a classic disagreement among experts on methodology, which is insufficient to overturn the City's finding."
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> *Demonstrable Savings* – The judge held there was evidence to support the City's finding that its decision to issue lease-revenue bonds, rather than monetizing the City's parking assets, would result in a better deal for the City because the bonds are "stronger credit" and the City would receive "better market reception," "better credit rating," and, ultimately, a "better interest rate." The judge held that plaintiffs failed to show that there is no evidence to support the finding that issuance of bonds will result in demonstrable savings in interest rate, bond preparation, bond underwriting, or bond issuance costs.

The judge decided that "plaintiffs have failed to meet their burden of proof on any of their causes of action" and awarded the recovery of defense costs. California cities issuing bonds under the Marks-Roos Act can refer to the *Gonzalez* Proposed Statement of Decision for insight on the type of information that needs to be in the record to meet the supporting evidence requirement of the Act in order to withstand a potential legal challenge.

A template going forward

Arena projects generate controversy that can at times be as strong and emotional as fans' support for their teams, and the new downtown arena for the Kings in Sacramento was no exception. Despite general public support, opponents used a myriad of legal maneuvers in their many attempts to delay and derail the project. The City overcame all legal challenges and the arena is on track for timely completion in 2016, thus turning Sacramento's story into a strategic game plan that sponsors can use to overcome efforts to stall or thwart new arenas, as well as other major economic development projects.