SUPREME COURT OF THE STATE OF CALIFORNIA

Stephen K. Davis Plaintiff and Respondent v. Fresno Unified School District, and Harris Construction Co., Inc. Defendants and Petitioners	No. S266344 Court of Appeal No. F079811

After a Published Decision by the Court of Appeal,
Fifth Appellate District

PETITIONER HARRIS CONSTRUCTION CO.'S REPLY BRIEF

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INTRODUCTION

Several aspects of Davis's Answering Brief are notable.

First, Davis does not dispute any of the facts we summarized at the outset of our Opening Brief. Indeed, at pages 12–13, footnote 1, of his Answering Brief, he states that he does not object to this Court's consideration of the documents we cited.

Second, at pages 7–12, Davis argues that California law generally permits taxpayer's suits and invalidates public contracts infected with conflicts of interest. Our Opening Brief disputes neither proposition, and we do not dispute them in this Reply Brief. The issue designated by this Court deals with the coverage of the validation statutes, not with taxpayer's suits and conflicts of interest. We contend that the validity of lease-leaseback contracts funded by tax-exempt bonds must be determined pursuant to the validation statutes.

Third, while Davis avers that the lease-leaseback contracts at issue in this case were invalid "for their failure to comply with applicable public contracting statutes and/or conflict of interest prohibitions" (Answering Brief at 7), he never tells this Court exactly what he contends was done wrong. See also RB 47–49,

where Davis quotes portions of his complaint that are equally vague and nonspecific. Mr. Davis is a contractor who appears to be upset that FUSD awarded to Harris, not Davis, the contract to construct the middle school.[1] Davis apparently believes he would have had a better chance with competitive bidding. But FUSD was not required to use competitive bidding, because the Education Code exempts lease-leaseback contracts from competitive bidding. *California Taxpayers Action Network v. Taber Construction, Inc.* (2017) 12 Cal.App.5th 115, 130–131; *Los Alamitos Unified School District v. Howard Contracting, Inc.* (2014) 229 Cal.App.4th 1222.[2]

Regarding Davis's conflict-of-interest claim, Davis does not allege that any FUSD board member or official had a financial stake in the selection of Harris to build the school — or anything

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[1] Mr. Davis is president of Davis Moreno Construction, Inc., one of Harris's rivals in competing for school district construction contracts. *Davis I*, 237 Cal.App.4th at 273, fn. 4.

[2] And Education Code section 17406 requires a type of competitive bidding *within* the process of selecting a lease-leaseback contractor. See Education Code 17406, subsection (a)(2): "An instrument created pursuant to paragraph (1) shall be awarded based on a competitive solicitation process to the proposer providing the best value to the school district, taking into consideration the proposer's demonstrated competence and professional qualifications necessary for the satisfactory performance of the services required."

of a kind. And Davis makes no claim that Fresno Unified or Harris failed to comply with any of the requirements set out in the statute that authorizes lease-leaseback contracts. Davis apparently contends only that it was improper for FUSD to retain Harris as its initial consultant, and later sign a lease-leaseback contract with Harris to build the project. But nothing in the lease-leaseback statute (Education Code section 17406) bars such an arrangement, which in certain instances may be the most efficient way to handle a lease-leaseback.

Fourth, at page 20, footnote 2, of Davis's Answering Brief, Davis claims that he "did not seek an injunction so as to not delay the construction of needed school facilities for the District's students and teachers." A commendable motive, if sincerely held. In fact, however, a taxpayer's lawyer stands to make much more money if he allows the project to be completed, and then seeks disgorgement. In a taxpayer's suit, a successful outcome justifies an attorneys fees based on hours spent, an hourly rate, plus a multiplier. *Vasquez v. State of California* (2008) 45 Cal.4th 243; *Press v. Lucky Stores, Inc.* (1983) 34 Cal.3d 311, 322. The multiplier might be much higher if a taxpayer's counsel allows the project to be completed and then recovers disgorgement,

because then the school district would have ownership of a new school at no or reduced cost. See *Thompson v. Call* (1985) 38 Cal.3d 633, 646; *Miller v. McKinnon* (1942) 20 Cal.2d 83, 89. An injunction, however, simply results in no school at no cost.

I. LEASE-LEASEBACK CONTRACTS ARE INTEGRAL TO THE BONDS THAT FINANCE THEM.

A. Due to Federal Income Tax Laws, Lease-Leaseback Contracts and the Bonds Are Directly Related.

At pages 25–33 of his Answering Brief, Davis contends that a school district's inability to meet the IRS's three-year limit on completion of construction does not threaten the tax-exempt status of the bonds used to finance the project. However, FUSD's Reply Brief — prepared with the assistance of bond counsel with over two decades of experience in this area — shows that this is simply not true.

FUSD's Reply Brief cites reported instances where, because the 3-year limit was violated, the IRS revoked the tax-exempt status of the bonds.

And FUSD's bond counsel avers that if the validation statutes may not be used to resolve the validity of lease-leaseback contracts funded by bonds — thereby enabling plaintiffs to challenge validity well after the 60-day period and delay completion for more than three years — bond counsel will be unable to issue an unqualified opinion assuring prospective bondholders as to tax-exempt status of the bonds. And "[w]ithout

a clean tax opinion the bonds will not be able to be sold." There could be no more powerful connection between the validity of lease-leaseback contracts and the bonds that fund them.

At page 28 of his Answering Brief, Davis proposes a solution to these problems: the school district should simply surrender its right to any funds from temporary arbitrage. This "solution" alone shows that the validity of lease-leaseback contracts is integral to the validity of the supposedly tax-exempt bonds that fund them. To assure validity, the district would need to give up many thousands of arbitrage dollars that districts use to help build schools.

B. Lease-Leaseback Contracts Facilitate Payment of the Bonds That Funded Them.

At page 10 of his Answering Brief, Davis admits that "the bonds that funded construction of the Project were general obligation bonds paid for by ad valorem taxes levied on all taxable real property (and certain personal property) across the entire District ... ."

But Davis does not dispute our contention (at pages 29–31 of our Opening Brief) that this fact makes the lease-leaseback

contracts integral to the bonds that fund them — because new and remodeled schools raise the values of properties that are taxed to pay for the bonds, and thereby help the taxpayers pay the added tax.

II. DAVIS IS NOT ENTITLED TO A TRIAL.

At pages 41–50 of his Answering Brief, Davis contends that even if this Court holds that the validity of lease-leaseback contracts may be determined in a validation action, Davis is nevertheless entitled to a trial on his disgorgement cause of action.

We disagree. The Legislature intended the validation statutes to provide a speedy remedy to determine the validity of certain instruments. Allowing a litigant to add other causes of action could significantly delay a final judgment on that validity, thereby undermining the central purpose of the validation statutes. Those statues do not provide for the joinder of additional causes of action, and we are aware of no case that allows this.

In Government Code sections 53511 et. seq., the Legislature created *in rem* actions that provide a very speedy determination of the validity of public agency financing arrangements. Such actions must be filed quickly, within 60 days of the agency's action. Code Civ. Proc. §§ 860, 863. These actions are entitled to precedence over other civil cases. Code

Civ. Proc. § 867. And the validation statutes provide the *exclusive* remedy for challenging the validity of the lease-leaseback contract. *Green v. Community Redevelopment Agency* (1979) 96 Cal.App.3d 491, 495, 501–502.

At pages 41–43 of our Opening Brief, we cited several cases that recognize this central purpose of the validation statutes: to provide a speedy resolution of the validity of financing arrangements. See, e.g., *McGee v. Torrance Unified School District* (2020) 49 Cal.App.5th 814, 822 (the validation statutes "fulfill the important objective of facilitating a public agency's financial transactions with third parties by quickly affirming their legality. In particular, the fact that litigation may be pending or forthcoming drastically affects the marketability of public bonds"); *McLeod v. Vista Unified School Dist.* (2008) 158 Cal.App.4th 1156, 1166 ("The validating statutes contain a 60-day statute of limitations to further the important public policy of speedy determination of the public agency's action … The validating statutes should be construed so as to uphold their purpose, i.e., the acting agency's need to settle promptly all questions about the validity of its action"); *Millbrae School Dist. v. Superior Court* (1989) 209 Cal.App.3d 1494, 1497 ("a central

theme in the validating procedures is speedy determination of the validity of the public agency's action").

Allowing remedial or other causes of action to be litigated in a validation or reverse validation action could significantly delay a final determination regarding validity. Suppose, for example, a plaintiff joins a claim for a determination of invalidity with a cause of action for disgorgement (as Davis did). The trial court finds the contract invalid, but the school district disagrees and wants to appeal that finding. The school district cannot do so, because the disgorgement claim is still pending. "There is only one final judgment, the last or ultimate judgment that determines the rights of the parties." 7 Witkin, Cal. Proc. 5th *Judgment,* § 7 (2020).

The district might consider seeking a writ of mandate from the court of appeal, challenging the pre-judgment finding of invalidity. But such writs are discretionary, and are often denied without explanation. Also, the trial court might defer ruling on the validity claim until trial on all claims (i.e., after extensive discovery and motions on the disgorgement claim are completed), thereby delaying a ruling on validity that might be cured by a writ.

Davis would have the school district, the prospective bondholders, the contractor and the public wait for months or even years to learn whether the project may proceed as planned by the public and their elected representatives. And the children who need the new school must wait.

The rule we propose is the same rule that applies to unlawful detainer actions, where it serves the same purpose: the need for speed. "Speedy adjudication is desirable to prevent subjecting the landlord to undeserved economic loss and the tenant to unmerited harassment and dispossession when his lease or rental agreement gives him the right to peaceful and undisturbed possession of the property." *Martin-Bragg v. Moore* (2013) 219 Cal.App.4th 367, 388. Therefore, no other causes of action may be joined with a claim for unlawful detainer. "In unlawful detainer proceedings, ordinarily the only triable issue is the right to possession of the disputed premises, along with incidental damages resulting from the unlawful detention." *Id.* at 385. See also *Larson v. City & County of San Francisco* (2011) 192 Cal.App.4th 1263, 1297 ("The statutory scheme is intended and designed to provide an expeditious remedy for the recovery of possession of real property. [Citation] Unlawful detainer actions

are, accordingly, of limited scope, generally dealing only with the issue of right to possession and not other claims between the parties, even if related to the property"); *Lincoln Place Tenants Ass'n v. City of Los Angeles* (2007) 155 Cal.App.4th 425, 452 ("Unlawful detainer actions are necessarily expedited because of the limitations imposed on pleadings and issues that may be litigated. The only triable issue is the right to possession and incidental damages resulting from the unlawful detention").

Therefore, we submit that no other claim may be joined with a claim for a determination of the validity of school district financing arrangements. At pages 44–45 of his Answering Brief, Davis cites several cases holding that a taxpayer may sue to recover funds paid on an illegal contract, even after the project is completed. But to our knowledge, none of those cases were brought under the validation statutes. Under those cases, Davis is free to file a *new* taxpayer's lawsuit for whatever remedies might be legally available — but only if he first obtains a final judgment declaring the lease-leaseback contract invalid. But he

should not be allowed to join those claims in the validation action itself.[3]

III. THIS COURT SHOULD CONSIDER WHETHER CERTAIN OBJECTIONS TO LEASE-LEASEBACK CONTRACTS HAVE MERIT.

At page 50 of his Answering Brief, Davis objects to the portions of our Opening Brief which argue that — if this Court should reject our contention (at pages 46–73 of our Opening Brief) that the validity of lease-leaseback contracts come within the validation statutes — the Court should ameliorate the problems such a holding would impose on school districts, by rejecting the substantive holdings reached by the Fifth District Court of Appeal.

Davis argues that our contention is "unrelated" to the issue this Court designated for review.

We disagree, for several reasons.

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[3] As held in *McGee, supra,* 49 Cal.App.5th 814, a "reverse validation action was rendered moot by the completion of the challenged projects". *Id.* at 823. McGee's "years-long delay destroyed the very purpose behind the validation statutes — "to settle *promptly* all questions about the validity of an agency's action." *Ibid.* The same is true here.

First, the Fifth District's substantive holdings — if allowed to stand — would significantly exacerbate the adverse *effect* of a holding that lease-leaseback contracts are not subject to the validation statutes. This Court should consider that effect when deciding whether the validation statutes cover lease-leasebacks.

Second, when adopting any new rule, this Court can and should consider ancillary rules that will support the new rule or diminish its potential negative effects.

Third, at pages 41–46 of his Answering Brief, Davis contends that he has a right to trial on his claim that the lease-leaseback contract at issue in this case is invalid. If this Court agrees, then the Court should provide guidance to the trial court regarding the issues we raise. In particular, if the trial court finds that the lease-leaseback contract was invalid, is disgorgement of the entire contract price a proper remedy — even if Davis intentionally chose not to seek to enjoin the project before it was completed (see Answering Brief s p. 20, fn. 2)? Indeed, at page 12 of his Answering Brief, Davis himself expressly asks this Court to rule on this issue. And Davis argues this issue at pages 38–41 of his Answering Brief.

CONCLUSION

At a minimum, this Court should hold that lease-leaseback contracts issued by school districts are "intertwined" with the bonds that funded them, and therefore the validity of such lease-leaseback contracts may be determined under our validation statutes.

Date: July 22, 2021

Respectfully submitted,
Moskovitz Appellate Team

/s/ Myron Moskovitz
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CERTIFICATE OF WORD COUNT

I hereby certify that the attached Reply Brief, including footnotes, contains 2,421 words, according to the word count indicator on my Microsoft Word program.

Date: July 22, 2021

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STATE OF CALIFORNIA
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