Supreme Court of California
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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 OPENING BRIEF ON THE MERITS

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THE FACTS

The following facts appear in the two reported Court of Appeal opinions in this case: *Davis v. Fresno Unified School District* (2015) 237 Cal.App.4th 261 ("*Davis I*") and *Davis v. Fresno Unified School District* (2020) 57 Cal.App.5th 911 ("*Davis II*"), or are otherwise undisputed.

In 2001, Fresno voters approved Measure K, which allowed the Fresno Unified School District ("FUSD") to issue up to $199 million in bonds to "reduce overcrowding by building new classrooms/schools", to "renovate and modernize deteriorating classrooms", and to "repair, rehabilitate, construct and acquire educational facilities and related property" (among other projects).

Pursuant to this authorization, from 2001 through 2011, FUSD issued several Measure K General Obligation Bonds, each for the stated purpose of acquiring and constructing new schools and facilities and to improve and repair existing schools.

On September 26, 2012, FUSD approved a plan to use some of those bond funds to build the Rutherford B. Gaston Sr. Middle School, to serve children in southwest Fresno, a predominantly minority, low-income community. More than 90% of these

children are eligible for free school lunches. The school would replace the old, dilapidated Carver School, and serve some 600 local students who had been bussed out of their neighborhood.[1]

The school was to be built pursuant to a "lease-leaseback" arrangement — authorized by Education Code section 17400 et. seq., as an alternative to competitive bidding. FUSD leased the project site to Appellant Harris Construction Company for $1 dollar a month. Harris then subleased the property back to FUSD for monthly payments that would pay for the construction of the school. The total price was to be $36,702,876, and the school was to be built in 595 days.

On November 20, 2012, Stephen Davis[2] filed a "reverse validation" suit against FUSD and Harris, claiming that the arrangement did not satisfy the requirements of the Education Code, and that FUSD had a conflict of interest with Harris. The

[1] See Fresno Unified School District's Facilities Master Plan Fact Sheet, at https://www.fresnounified.org/wp-content/uploads/Facilities-Master-Plan.pdf and "Fresno Unified Picks Site For New Middle School", Fresno Bee, 9/17/10, at https://www.fresnobee.com/news/local/education-lab/article19506669.html

[2] 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.

trial court sustained demurrers to Davis's complaint, but in 2015, the Fifth District Court of Appeal reversed, holding that the deal was invalid. *Davis v. Fresno Unified School District* (2015) 237 Cal.App.4th 261 (*Davis I*).

In *Davis I,* the Court of Appeal did not question the use of the validation statute to raise this issue.

The Court held that the Legislature's main purpose in allowing lease-leaseback was to provide school districts with a new method of financing school construction, whereby the contractor could use his contract with the school district to obtain third-party financing for the project. *Id*. at 276–280. Because FUSD was using its own funds (obtained from a bond issue approved by Fresno's voters) instead of third-party financing to be obtained by Harris, this lease-leaseback arrangement was invalid. *Id*. at 280.

The Court of Appeal also concluded that the lease from Harris to FUSD (the "Facilities Lease") was invalid, because it was "not a true lease", as it did not provide for FUSD's occupancy of the school during the lease term. Therefore, the Facilities Lease violated the competitive bidding provisions of the Education Code. *Id.* at 287–289.

Davis had made no effort to seek an injunction stopping the project during the litigation. So, Harris — contractually bound by the "time of the essence" provision in its agreement with Fresno Unified — continued building the middle school.

Harris completed the work on December 4, 2014 (while the first appeal was pending). No one claimed that the work was faulty in any way, or that it was not completed in a timely manner. Harris had sought no extra money for "change orders" or the like. In fact, Harris returned $651,501 to FUSD.

The project was a success. More than 800 Fresno children now attend the Rutherford B. Gaston Sr. Middle School.[3] The school includes a full-service health center, providing needed health care to children and adults who cannot otherwise afford it.[4]

After the case was remanded to the trial court, defendants moved to dismiss the case as moot, because the construction was

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[3] See "Southwest Fresno Dedicates New Middle School", ABC News, 9/19/14, at https://abc30.com/education/southwest-fresno-dedicates-new-middle-school/316820/

[4] See "School Health Centers Are Big Boost for Fresno", Fresno Bee, 2/12/17, at https://www.fresnobee.com/opinion/editorials/article132083134.html

complete. The trial court agreed. Davis again appealed, and the Fifth District Court of Appeal again reversed — in another published opinion. *Davis v. Fresno Unified School District* (2020) 57 Cal.App.5th 911 (*Davis II*).

The Court of Appeal held in *Davis II* that because the lease-leaseback agreement with Harris did not include a financing element, it was not a "contract" subject to validation, and therefore "we conclude the contracts do not fall within the ambit of Government Code section 53511 and California's validation statutes. It follows that Davis may pursue a taxpayer's action seeking the remedy of disgorgement." *Id.* at 917; see also *id.* at 941–942. The Court held that "Disgorgement qualifies as effective relief, and, therefore, the taxpayer's action part of this lawsuit is not moot." *Id.* at 917.

Thus, because the Court had held that this lease-leaseback arrangement was invalid (because it did not require Harris to obtain the financing), Davis may now pursue his second claim: a "taxpayer's" claim that Harris must now disgorge the entire $36,702,876 (minus the $651,501 Harris already returned to

FUSD) — even though Harris has already paid the bulk of those funds to subcontractors and employees.[5]

[5] In 2016, Education Code §17406 was amended to provide that any disgorgement is limited to the contractor's profits. In the present case, however, Davis apparently contends that this limitation is not retroactive and does not apply to Fresno Unified's 2012 agreement with Harris.

THE ISSUE

This Court granted review on a single issue: "Is a lease-leaseback arrangement in which construction is financed through bond proceeds, rather than by or through the builder, a 'contract' within the meaning of Government Code section 53511?"

THE VALIDATION STATUTES

Government Code section 53511 provides:

> (a) A local agency may bring an action to determine the validity of its bonds, warrants, contracts, obligations or evidences of indebtedness pursuant to Chapter 9 (commencing with Section 860) of Title 10 of Part 2 of the Code of Civil Procedure.
>
> (b) A local agency that issues bonds, notes, or other obligations the proceeds of which are to be used to purchase, or to make loans evidenced or secured by, the bonds, warrants, contracts, obligations, or evidences of indebtedness of other local agencies, may bring a single action in the superior court of the county in which that local agency is located to determine the validity of the bonds, warrants, contracts, obligations, or evidences of indebtedness of the other local agencies, pursuant to Chapter 9 (commencing with

Section 860) of Title 10 of Part 2 of the Code of Civil Procedure.

Code of Civil Procedure section 860 provides:

> A public agency may upon the existence of any matter which under any other law is authorized to be determined pursuant to this chapter, and for 60 days thereafter, bring an action in the superior court of the county in which the principal office of the public agency is located to determine the validity of such matter. The action shall be in the nature of a proceeding in rem.

And Code of Civil Procedure section 863 provides for "reverse" validation lawsuits. It says, in part: "If no proceedings have been brought by the public agency pursuant to this chapter, any interested person may bring an action within the time [i.e., 60 days] and in the court specified by Section 860 to determine the validity of such matter".

Code of Civil Procedure section 867 provides:

> Actions brought pursuant to this chapter shall be given preference over all other civil actions before the court in the matter of setting the same for hearing or trial, and in hearing the same, to the end that such actions shall be speedily heard and determined. (Emphasis added.)

Code of Civil Procedure section 869 provides:

> No contest except by the public agency or its officer or agent of any thing or matter under this chapter shall be made other than within the time and the manner herein specified. The availability to any public agency, including any local agency, or to its officers or agents, of the remedy provided by this chapter, shall not be construed to preclude the use by such public agency or its officers or agents, of mandamus or any other remedy to determine the validity of any thing or matter.

A SUMMARY OF THIS BRIEF

1. The short answer to this Court's question is: It depends on whether the lease-leaseback arrangement is 'intertwined' with the bonds
2. Here, the lease-leaseback contract is intertwined with school district bonds, in two ways:
    a. School districts pay low interest rates on these bonds because the interest is exempt from income taxes. But under the law, the exemption is allowed only if the project is essentially completed within three years of the date the bonds are issued. If the validation statutes do not apply, someone might file suit to invalidate the lease-leaseback contract years after commencement of construction, *after* expiration of what would have been the validation period. This litigation might delay completion of the project *beyond* the three-year deadline and jeopardize the tax-exempt status of the bonds. This possibility of losing the tax exemption will discourage investors from purchasing such bonds at low interest rates and/or could expose the school district to lengthy and expensive litigation if bondholders purchased bonds

that were no longer tax exempt. As discussed below, Fresno Unified represented to bond purchasers that it would timely spend the bond construction funds and expected completion of the project within three years of the date of issuing the bonds.

b. The bonds were funded with assessments on properties in the District. The values of those properties were enhanced by the improvement in a District school, through the economies generated by the lease-leaseback contract. The rising values of those properties induced many voters to support the bond issue, and may facilitate their abilities to pay the assessments.

3. Because of school districts' need to assure that lease-leaseback arrangements are valid before construction begins, courts should give such "intertwining" a liberal construction — at least where school districts are involved — to implement the Legislature's intent that lease-leaseback be used as an effective vehicle for school construction and redevelopment.

4. In addition, if this Court finds that there has been *no* "intertwining" here, the effects of school districts' inability

to use the validation procedure would be ameliorated considerably if this Court now rejects several arguments the Fifth District (and only the Fifth District) has accepted as invalidating lease-leaseback arrangements. These arguments include: (1) the contract did not provide for financing by the contractor, and (2) the contract did not provide that the school district would occupy the property during the term of the lease. In addition, this Court should reject the Fifth District's holding that one may challenge the validity of a lease-leaseback contract after the construction has been completed, even though the challenger never sought to enjoin the project.

ARGUMENT

I. GOVERNMENT CODE SECTION 53511 MAY BE USED WHEN THE LEASE-LEASEBACK CONTRACT IS "AN INTEGRAL PART OF THE WHOLE METHOD OF FINANCING" THE PROJECT.

We hope, of course, that this Court would answer its question with an unqualified "yes".

However, we expect the Court to follow its decision in *City of Ontario v. Superior Court* (1970) 2 Cal.3d 335, 343, where the Court held that the Legislature did not intend the word "contract" in Government Code section 53511 to be read literally and broadly. Instead, the validation statute is limited to actions "to determine the validity of evidences of indebtedness". *Id.* at 343. *City of Ontario* was followed and applied in *Kaatz v. City of Seaside* (2006) 143 Cal.App.4th 13.

But *City of Ontario* did *not* hold that section 53511 applies only to *direct* challenges to "the validity of evidences of indebtedness".

An indirect challenge was upheld in *Graydon v. The Pasadena Redevelopment Agency* (1980) 104 Cal.App.3d 631. A redevelopment agency issued bonds to finance the construction of a subterranean garage to support a new retail shopping center,

and then approved a contract to build the garage. A taxpayer filed a petition for writ of mandate challenging the validity of *the construction contract*, because it was not issued pursuant to competitive bidding. The suit did not directly challenge the validity of the bonds.

Because the lawsuit was filed more than 60 days after agency had approved the contract to build the garage, the court held that the action was barred — even though the lawsuit did not directly challenge the validity of the bonds:

> The negotiated contract for the construction of the subterranean garage is *an integral part of the whole method of financing* the public costs associated with the retail center. The financing is by bonds issued by the Agency to be paid from tax increments allocated to the Agency. The record indicates that if completion of the retail center was delayed beyond March 1, 1980, because of delay in commencement of construction, a loss of tax increment revenue of $1,556,000 would result for the 1981-1982 fiscal year. There was evidence that if the contract were competitively bid, a delay of approximately 14 months would have resulted. It is uncontroverted that a considerable delay would have resulted. The ability of the Agency to pay its bonds, dependent in large part upon the flow of tax

> increment monies resulting from the completion of the retail center, was thus directly linked to the award of the questioned contract.
> [*Id.* at 645; emphasis added]

This analysis seems reasonable, and its resulting test — applying the validation statutes where a construction contract is "an integral part of the whole method of financing the public costs associated with the" project — also appears reasonable, as applied to public projects generally, including school district bonds.

So, we will assume that this is the test this Court will apply in the instant case.

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

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

The bonds that finance lease-leaseback contracts are issued by a school district, which is a California public agency. Therefore, the interest paid on those bonds is tax-exempt: the bondholder pays no federal income taxes on the interest earned

by the bonds.[6] This results in a higher net return to the purchasers of those bonds, and enables the school district to pay a significantly lower interest rate than it would if the interest were taxable.

But Congress has established certain *conditions* on the tax-exempt status of those bonds in the Internal Revenue Code.

The IRS generally does *not* allow tax exempt bonds to be used for "arbitrage." Internal Revenue Code section 103(b)(2) provides that the exclusion from gross income under section 103(a) shall not apply to any "arbitrage" bond within the meaning of Internal Revenue Code section 148(a). A public agency may not, in general, borrow money from bondholders at the usual low stated interest rate, then invest the proceeds in higher yielding investments, and keep the difference. If they do, the bond interest will no longer be tax exempt.

But there are exceptions. Where a public agency issues bonds to build public projects, there will usually be a lag period before all the bond proceeds are actually spent, e.g., while the

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[6] 26 U.S.C. § 103(a) ("gross income does not include interest on any State or local bond."). California generally exempts from its income tax interest from bonds issued by state or local governments. Rev. & Tax. Code § 17133.

agency is soliciting and lining up potential contractors, and before the final payment to the contractor is made. The IRS provides for "temporary arbitrage", which allows the agency to invest bond proceeds during this temporary period, and the bondholders will not lose their tax exemptions — *if and only if* the agency complies with certain restrictions. Internal Revenue Code § 148(c).

We are informed that virtually every school district in California takes advantage of temporary arbitrage, to add additional funds to their construction projects.

One of the IRS restrictions on temporary arbitrage appears in Treas. Reg. §1.148-2(e)(2), which generally requires the construction to be *completed within three years* from the date the bonds were issued.

The IRS has explained these restrictions in IRS Publication 5271, *Complying with Arbitrage Requirements: A Guide for Issuers of Tax Exempt Bonds*. See https://www.irs.gov/pub/irs-pdf/p5271.pdf. This publication states:

- "Generally, bonds lose their tax-exempt status if they are arbitrage bonds under IRC Section 148." *Id*. at p. 2.

- "The yield restriction rules provide that bonds are arbitrage bonds if the issuer expects to invest or actually invests all or part of the gross proceeds in investment property having a yield materially higher than the bond yield." *Id.* at p. 7.
- "During a 'temporary period,' the issuer may invest bond proceeds at an unrestricted yield without causing the bonds to be arbitrage bonds under the yield restriction rules." *Id.* at p. 9.
- "A 3-year temporary period is available for bond proceeds deposited in a construction or project fund when those proceeds are expected to be allocated to acquisition or construction costs of a capital project. *The temporary period begins on the date the bonds are issued and ends 3 years later.* The 3-year temporary period may be extended another 2 years for a total of 5 years if the issuer and a licensed architect or engineer certify that more than 3 years are necessary to complete the capital project." *Id.* at p. 9; emphasis added.

If someone could challenge a lease-leaseback well after the 60-day period provided by the validation statutes, it is quite likely that this three-year requirement would not be met.

Someone might file suit during the first year, perhaps obtain a preliminary injunction against the construction, and maybe conclude the litigation after a year or two. If the court determines that the lease-leaseback did not meet the statutory requirements for some reason, there may be insufficient time for the school district to correct any problem with the contract and reissue it. And even if the court approves the lease-leaseback contract, if a preliminary injunction has delayed the project, it might not be finished within the three-year deadline.

If the projected is not completed within the three-year period, the IRS might deny bondholders the right to declare their income from the bonds tax-exempt. The very *possibility* of that happening is likely to discourage potential bondholders from purchasing the bonds in the first place. Or, they might buy the bonds only if the bonds pay an interest rate significantly higher, to account for this risk. As stated in *Walters v. County of Plumas* (1976) 61 Cal.App.3d 460, 468:

> We perceive the essential difference between those actions which ought and those which ought not to come under [the validation statutes] to be *the extent to which the lack of a prompt validating procedure will impair the public agency's ability to operate.* The fact

> that litigation may be pending or forthcoming drastically affects the marketability of public bonds; it has little effect upon such matters as a contract with a public defender or the purchase of a computer. We feel that the possibility of future litigation is very likely to have a chilling effect upon potential third party lenders, thus resulting in higher interest rates or even the total denial of credit, either of which might well impair the county's ability to maintain an adequate waste disposal program.
>
> [See also *McLeod v. Vista Unified School Dist.* (2008) 158 Cal.App.4th 1156, 1167–1168.]

In the present case, the bonds used to fund the lease-leaseback contract to replace the old Carver school with the new Rutherford B. Gaston Sr. Middle School were subject to this three-year completion requirement. On October 13, 2011, soon after the final Measure K General Obligation Bond was issued, FUSD's Superintendent of Schools issued a "Certificate of Arbitrage", which expressly deals with this issue.[7] The Certificate includes the following provisions:

[7] See https://facilities.fresnounified.org/measure-q-measure-x-bond/ link, titled "Arbitrage Certificate" under "Bond Documents".

- "The Bonds are being issued for the purpose of providing funds for the acquisition and construction of certain public educational facilities (the 'Project') ... ." Section 1.
- "The District has entered into a contract for construction with respect to the Project ... ." Section 2(d)
- "The District will proceed with due diligence to complete the Project and to spend the proceeds of the Bonds. Completion is expected by September 1, 2014." Section 2(d).
- "Not less than eighty-five percent (85%) of the Net Sale Proceeds [from the bond sales] will be spent within three (3) years of the date hereof." Section 2(d).
- "Proceeds of the Bonds and interest earnings and gains thereon, if any, remaining in the Building Funds following the 3-year Temporary Period will be invested at a yield not in excess of the yield of the Bonds (see below) or yield reduction payments under Section 148 of the Internal Revenue Code of 1986, as amended ... ." Section 2(d).

"Section 148 of the Internal Revenue Code of 1986" is, of course, the basis for the requirement that construction be completed within three years.

The expected completion date (September 1, 2014) was just a few days before expiration of three years from the date the bonds were issued (October 13, 2011). Construction of the school was completed shortly after the three years expired — on December 4, 2014.

A challenge under the validation statutes would be speedily resolved without seriously impairing the three-year window.

Conversely, if the validation statute did not apply, mid-way through the project Davis would have been free to seek an injunction halting construction. If such an injunction were issued, the three-year rule would have been significantly breached, and the bond-holders' tax exemption might have been jeopardized. Indeed, the parties are still litigating the efficacy of the bond issued lease-leaseback contract — almost 10 years after the bonds were issued.

B. The Lease-Leaseback and the Bonds Are Also Indirectly Related.

In 2001, Fresno voters approved a bond issue of $199 million that provided the funds to pay for the construction of the Rutherford B. Gaston Sr. Middle School.

The bond indebtedness was to be paid through assessments on real properties in Fresno, to be added to property owners' property tax bills.

These bonds and the lease-leaseback contract were intimately connected. The purpose of the lease-leaseback contract was to build a new middle school for Fresno students. The quality of a community's schools has a direct effect on the community's property values. It is common knowledge that when school quality rises, so do local property values. One study found that "A $1.00 increase in per pupil state aid increases aggregate per pupil housing values by about $20.00, indicating that potential residents value education expenditure." https://www.nber.org/digest/jan03/school-spending-raises-property-values .

Rising property values enable property owners to obtain higher loans, build equity, receive higher rents, and generally to

pay more property taxes — including special assessments such as this one. Indeed, it is highly likely that many voters supported the measure because it would increase the values of their properties.

The lease-leaseback contract will probably not result in higher property values until the construction is finished, so potential property buyers and renters can see the completed school. If the construction is delayed by legal challenges to the lease-leaseback contract, this will postpone the rise in property values — and thus undermine the ability of property owners to pay the assessments imposed for repayment of the bond indebtedness.

Thus, the lease-leaseback contract was "an integral part of the whole method of financing" the project. And therefore Mr. Davis's lawsuit should have been considered subject to the validation procedure established by Government Code section 53511 et. seq. That was his 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.

Therefore, the Court of Appeal erred in allowing him to challenge it via a taxpayer's claim for disgorgement.[8]

[8] In the lower courts, none of the parties claimed that this lawsuit was not subject to the validation statutes. Therefore, none of them introduced evidence regarding whether Fresno Unified's lease-leaseback contract was "integral" with the bonds that financed the contract. The two arguments in the text above claim that *all* school district lease-leaseback contracts are integral to the bonds that fund them. If this Court does not accept those arguments, then we request this Court to remand the case to the trial court to determine whether this particular lease-leaseback contract was integral with the bonds.

III. "INTEGRAL" SHOULD BE LIBERALLY CONSTRUED TO ALLOW VALIDATION OF CONTRACTS TO BUILD SCHOOLS.

If any doubt remains about whether a school district's lease-leaseback contract is integral to the bonds that fund it, that doubt should be resolved in favor of liberal use of the validation statutes by school districts.

A. Schools Are Special.

In California, schools are special.

The California Constitution does not command state government to provide automobile racing stadiums (*cf. City of Ontario, supra*), housing developments (*cf. Kaatz, supra*), or subterranean parking garages (*cf. Graydon, supra*.)

But an entire Article of our State Constitution — Article 9 — is devoted to education.

Section 1 of Article 9 provides:

> A general diffusion of knowledge and intelligence being essential to the preservation of the rights and liberties of the people, the Legislature shall encourage by all suitable means the promotion of

> intellectual, scientific, moral, and agricultural improvement.

This Court has recognized the importance of education, to foster an electorate capable of furthering democracy and good government. The Court elaborated on this theme in *Hartzell v. Connell* (1984) 35 Cal.3d 899, stating: "Without high quality education, the populace will lack the knowledge, self-confidence, and critical skills to evaluate independently the pronouncements of pundits and political leaders." *Id*. at 906–908.

Section 5 of Article 9 of our Constitution commands the Legislature to provide schools:

> The Legislature shall provide for a system of common schools by which a free school shall be kept up and supported in each district at least six months in every year, after the first year in which a school has been established.

And Section 6 of Article 9 provides:

> The Public School System shall include all kindergarten schools, elementary schools, secondary schools, technical schools, and State colleges,

B. School Districts Need to Be Able to Use Lease-Leaseback Contracts

Schools require school buildings. Gone are the days when Socrates taught his students beneath an olive tree.

In Education Code section 17001(a), the Legislature provided: "The Legislature hereby declares that it is in the interest of the state and the people thereof for the state to reconstruct, remodel, or replace existing school buildings that are educationally inadequate or that do not meet present-day structural safety requirements … ."

The Legislature has provided school districts with two mechanisms for constructing and renovating school buildings: competitive bidding and — a more recent development — lease-leaseback contracts.

Education Code section 17406 — the statute authorizing school districts to use lease-leaseback - is probably the longest, most detailed statute in the Education Code. Its very length demonstrates the attention the Legislature devoted to it — and its intent that the lease-leaseback be used.

The Legislature implicitly recognized that in a state as large and diverse as California — with almost 40 million

residents living in urban, suburban, and rural counties, each with varying interests and obstacles — the needs of these districts would vary widely.

The amicus letters submitted to this Court in support of the petitions for review in this case bear this out. School District officials across the State have submitted amicus letters explaining how they have used the broad discretion given by the Legislature to employ the lease-leaseback method in a variety of situations:

- "School districts use this construction delivery method as an effective, efficient, and cost and time saving tool, as well as a means to address specific, unique situations, such as developer built schools, construction projects funded by donors, or projects needed on an expedited basis to accommodate spikes in student enrollment." [Amicus letter submitted by California Association of School Business Officials.]

- School districts "throughout California collectively spend billions of taxpayer dollars on school construction and modernization projects each year. To complete

construction projects, schools can choose from different project delivery methods, including lease-leaseback. Lease-leaseback is widely used among schools for many reasons, including project financing, contractor expertise, and cost control."

[Amicus letter submitted by California School Boards Association's Education Legal Alliance.]

- "California has approximately 1,000 school districts and 10,000 school campuses. Those campuses contain classrooms, laboratories, libraries, gymnasiums, cafeterias, multipurpose rooms, play fields and other educational facilities. * * * * [O]ver the past 15 years, many California school districts have relied increasingly on the lease-leaseback method authorized by Education Code section 17406 to deliver their construction projects. Lease-leaseback has been relied upon throughout California to complete approximately 256 projects by school districts and county offices. Many districts are under contract currently using that method as they use

this time of pandemic induced vacant campuses to address school major infrastructure needs.

The lease-leaseback method is an alternative to the traditional design-bid-build process of construction. The lease-leaseback method allows a district to publicly advertise project plans and specifications and to award the project to the contractor providing the "best value" to the district based on multiple factors including price, qualifications, expertise, past experience and other criteria related to a contractor's ability to perform a specific project. It also facilitates a partnering relationship between a district and a contractor. The cooperation engendered by the process is one of the primary reasons that lease-leaseback projects are more likely to come in on time and within a district's budget. Also, lease-leaseback projects often result in fewer claims and litigation, which is also a cost savings to school districts. In contrast the design-bid-build process is blind to expertise, qualifications and past experience of contractors thus requiring a school district or county

office to rely solely on the lowest price stipulated in all bids offered in awarding the contract.

[Amicus letter submitted by California's Coalition for Adequate School Housing.]

- "The Long Beach Unified School District is the fourth largest public K-12 school district in the state ... .

  The Long Beach Unified School District is currently executing approximately $3.0B in campus improvement projects approved and funded by local general obligations bonds. The District has utilized various construction delivery methods, including Lease-Leaseback to bring much needed campus improvements to the community. The District considers the Lease-Leaseback delivery model to be a valuable method to bring timely & cost effective projects to our students.

  The lease-leaseback method is an alternative to the traditional design-bid-build process of construction. The lease-leaseback method allows a district to publicly advertise project plans and specifications and to award

the project to the contractor providing the "best value" to the district based on multiple factors including price, qualifications, expertise, past experience and other criteria related to a contractor's ability to perform a specific project. It has been our experience that it also facilitates a partnering relationship between our District and the contractor. We believe that the cooperation engendered by the process is one of the primary reasons that lease-leaseback projects are more likely to come in on time and within the District's budget. Also, our lease-leaseback projects have resulted in fewer claims and litigation, which has resulted in a significant cost savings. In contrast, the design-bid-build process provides limited access to the expertise, qualifications and past experience of contractors thus the District must rely on the lowest price stipulated in all bids offered in awarding the contract.

[Amicus letter submitted by Long Beach Unified School District]

In its amicus letter, Palm Springs School District explains why its *remote geographical location* makes lease-leaseback contracts especially useful to this particular district:

> The Palm Springs Unified School District is located in Coachella Valley and serves 21,000 students in the cities of Palm Springs, Cathedral City, Desert Hot Springs, Rancho Mirage, Palm Desert and Thousand Palms area. Since 2010, the district has constructed over $200 million in new school construction, renovation, energy efficiency and solar projects. The Coachella Valley is not home to large commercial school builders and is roughly 100 miles outside of Los Angeles area, thus it is hard to compete and attract highly qualified school construction firms. The lease-leaseback method has allowed the District to publicly advertise project plans and specifications and to award the project to the contractor providing the "best value" to the district based on multiple factors including price, qualifications, expertise, past experience and other criteria related to a contractor's ability to perform a specific project. It has been our experience that it also facilitates a partnering relationship between our District and the contractor. We believe that the cooperation engendered by the process is one of the primary reasons that lease-leaseback projects are more likely come in on time and

> within the District's budget. Also, our lease-leaseback projects have resulted in zero claims and litigation, which has resulted in significant cost savings.

C. School Districts Need to Use the Validation Statutes.

Lease-leaseback contracts appear to be especially susceptible to legal challenges based on alleged "conflict of interest" and lack of competitive bidding — especially from rival contractors, as happened in the instant case. It is extremely important to school districts to have such challenges resolved quickly, via the validation statutes.

In *McGee v. Torrance Unified School District* (2020) 49 Cal.App.5th 814, the court explained the purpose of the validation statutes:

> A key objective of a validation action is to limit the extent to which delay due to litigation may impair a public agency's ability to operate financially." To that end, the validation statutes enable a speedy determination of the validity of the public agency's action ... placing great importance on the need for a single dispositive final judgment. 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. They 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.
>
> [*Id.* at 822, internal citations and quotation marks omitted. See also *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".]

And in *McLeod, supra,* 158 Cal.App.4th at 1166, the court held:

> 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.'"

Amicus letters supporting the petitions for review in this case explained the real-world effect of the Court of Appeal's

ruling in this case that school districts may not use the validation statutes. In its amicus letter, Long Beach Unified School District stated:

> Validation has for years been viewed as a means by which districts could assure that a lease-leaseback project was in conformance with California law and any potential challenges would be addressed and resolved before the district expended considerable funds on construction.

Clovis Unified School District noted that the Court of Appeal opinion "sends the message that construction projects can be challenged years after completion under a taxpayer suit which presumably has a 3 year statute of limitations. This creates uncertainty and an unacceptable litigation risk."

Nine other school districts sent amicus letters stating that:

> Davis II allows for challenges to LLB contracts well after the 60-day validation period. As a result, a taxpayer or contractor could challenge a contract that the District thought was properly awarded under a bond funded LLB perhaps up to 3 years after project completion. The District could then find itself involved in years of litigation with a taxpayer who claims under

Davis II that the contract was just a "construction contract" and not subject to validation.[9]

Thus, to safely proceed with the project, *the district would need to defer the beginning of construction until at least three years after the contract is issued*. See Code Civ. Proc. § 338, subsection (a).[10] And if a suit were filed near the end of that three years, this would add another year or two (at least) of litigation time to the delay.

These delays will harm the district and its children, who need new construction and redevelopment as soon as possible. It would also harm potential contractors, who could not accurately predict the costs of labor and materials that far in advance. Many contractors will simply stop bidding on school district projects — to the detriment of districts and their students.

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[9] See amicus letters from Superintendents of the following school districts: Carruthers, Natomas, Paso Robles, Madera, Riverdale, Twin Rivers, Dinuba, Sanger, and Kings Canyon.

[10] Code of Civil Procedure section 526a provides that a taxpayer must file his lawsuit within one year after he paid a tax that funded the agency he is suing.

And, of course, as discussed above, such delays could threaten the tax-exempt status of any bonds issued to fund the project.

Granted, the Legislature has not expressly stated that lease-leaseback contracts are subject to the validation statutes. But in light of the Constitutional provisions endorsing education, the Legislature's statements regarding education, and the reports from school district officials regarding what is actually happening regarding lease-leasebacks, we submit that this Court should interpret "integral" liberally when determining the scope of the validation statutes as applied to school districts.

IV. THIS COURT SHOULD REJECT CERTAIN CHALLENGES TO THE VALIDITY OF LEASE-LEASEBACK CONTRACTS.

The confusion wrought by the two *Davis* cases has already put a serious crimp in the use of lease-leaseback contracts for school construction and redevelopment. Fresno Unified — the third-largest school district in the State, serving more than 70,000 students — has simply stopped using them. See Fresno Unified's Petition for Review at p. 1.

And this occurred at a time when school districts generally believed that they could use the validation statutes to resolve any potential challenges to lease-leaseback contracts early and quickly. If, for some reason, this Court should now hold that the connection between Fresno Unified's lease-leaseback contract was not sufficiently integral with its bond issue, and therefore the validation statutes do not apply, this result — combined with the Fifth District's decisions allowing several challenges to lease-leaseback on the merits — will further discourage school districts from using lease-leaseback at all.

To ameliorate this problem, *if* this Court holds that the validation statutes do not apply in this case, the Court should

now hold that the claims allowed by the Fifth District in *Davis I* and *Davis II* are without merit.

A. The Lease-Leaseback Statute

Education Code section 17406 is the statute that authorizes lease-leasebacks. In full, it currently provides:

> (a)(1) Notwithstanding Section 17417, the governing board of a school district may let, for a minimum rental of one dollar ($1) a year, to a person, firm, or corporation real property that belongs to the school district if the instrument by which this property is let requires the lessee therein to construct on the demised premises, or provide for the construction thereon of, a building or buildings for the use of the school district during the term of the lease, and provides that title to that building shall vest in the school district at the expiration of that term. The instrument may provide for the means or methods by which that title shall vest in the school district before the expiration of that term, and shall contain other terms and conditions as the governing board of the school district may deem to be in the best interest of the school district.
>
> (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. Before awarding an instrument pursuant to this section, the governing board of the school district shall adopt and publish required procedures and guidelines for evaluating the qualifications of proposers that ensure the best value selections by the school district are conducted in a fair and impartial manner. These procedures and guidelines shall be mandatory for the school district when awarding an instrument pursuant to this section. The required procedures shall include, at a minimum, the following:

(A) The school district shall prepare a request for sealed proposals from qualified proposers. The school district shall include in the request for sealed proposals an estimate of price of the project, a clear, precise description of any preconstruction services that may be required and the facilities to be constructed, the key elements of the instrument to be awarded, a description of the format that proposals shall follow and the elements they shall contain, the standards the school district will use in evaluating proposals, the date on which proposals are due, and

the timetable the school district will follow in reviewing and evaluating proposals.

(B) The school district shall give notice of the request for sealed proposals in the manner of notice provided in Section 20112 of the Public Contract Code and in a trade paper of general circulation published in the county where the project is located, with the latest notice published at least 10 days before the date for receipt of the proposals.

(C) A proposer shall be prequalified in accordance with subdivisions (b) to (m), inclusive, of Section 20111.6 of the Public Contract Code in order to submit a proposal. If used, electrical, mechanical, and plumbing subcontractors shall be subject to the same prequalification requirements for prospective bidders described in subdivisions (b) to (m), inclusive, of Section 20111.6 of the Public Contract Code, including the requirement for the completion and submission of a standardized prequalification questionnaire and financial statement that is verified under oath and is not a public record. These prequalification requirements shall be included in an instrument created pursuant to paragraph (1).

(D) The request for sealed proposals shall identify all criteria that the school district will consider in evaluating the proposals and qualifications of the proposers, including relevant experience, safety

record, price proposal, and other factors specified by the school district. The price proposal shall include, at the school district's discretion, either a lump-sum price for the instrument to be awarded or the proposer's proposed fee to perform the services requested, including the proposer's proposed fee to perform preconstruction services or any other work related to the facilities to be constructed, as requested by the school district. The request for proposals shall specify whether each criterion will be evaluated pass-fail or will be scored as part of the best value score, and whether proposers must achieve any minimum qualification score for award of the instrument under this section.

(E) For each scored criterion, the school district shall identify the methodology and rating or weighting system that will be used by the school district in evaluating the criterion, including the weight assigned to the criterion and any minimum acceptable score.

(F) Proposals shall be evaluated and the instrument awarded under this section in the following manner:

(i) All proposals received shall be reviewed to determine those that meet the format requirements and the standards specified in the request for sealed proposals.

(ii) The school district shall evaluate the qualifications of the proposers based solely upon the criteria and evaluation methodology set forth in the request for sealed proposals, and shall assign a best value score to each proposal. Once the evaluation is complete, all responsive proposals shall be ranked from the highest best value to the lowest best value to the school district.

(iii) The award of the instrument shall be made by the governing board of the school district to the responsive proposer whose proposal is determined, in writing by the governing board of the school district, to be the best value to the school district.

(iv) If the selected proposer refuses or fails to execute the tendered instrument, the governing board of the school district may award the instrument to the proposer with the second highest best value score if the governing board of the school district deems it to be for the best interest of the school district. If the second selected proposer refuses or fails to execute the tendered instrument, the governing board of the school district may award the instrument to the proposer with the third highest best value score if the governing board of the school district deems it to be for the best interest of the school district.

(v) Notwithstanding any other law, upon issuance of a contract award, the school district shall

publicly announce its award, identifying the entity to which the award is made, along with a statement regarding the basis of the award. The statement regarding the school district's contract award and the contract file shall provide sufficient information to satisfy an external audit.

(G) The governing board of the school district, at its discretion, may reject all proposals and request new proposals.

(3) Following the award of an instrument created pursuant to paragraph (1), and if the price proposal is not a lump sum for the instrument awarded, the successful proposer shall provide the school district with objectively verifiable information of its costs to perform the services requested under the instrument and shall select subcontractors as set forth in paragraph (4). Once any preconstruction services are completed and subcontractors are selected, and upon approval of the plans and specifications for work on the site by the Department of General Services' Division of the State Architect, if required, the successful proposer and the school district shall finalize the price for the services to be provided under the instrument. The successful proposer shall provide the school district with written rationale for the price, and the school district shall approve or reject the final price at a public meeting before the successful

proposer may proceed with any further work under the instrument. The contract file shall include documentation sufficient to support the final price determination.

(4)(A) The school district, in the request for sealed proposals, may identify specific types of subcontractors that must be included in the proposal. All subcontractors that are identified in the proposal shall be afforded the protections of the Subletting and Subcontracting Fair Practices Act (Chapter 4 (commencing with Section 4100) of Part 1 of Division 2 of the Public Contract Code).

(B) Following the award of an instrument created pursuant to paragraph (1) and for subcontractors not identified in the proposal, the successful proposer shall proceed as follows in awarding construction subcontracts with a value exceeding one-half of 1 percent of the price allocable to construction work:

(i) Provide public notice of availability of work to be subcontracted in accordance with the publication requirements applicable to the competitive bidding process of the school district, including a fixed date and time on which qualifications statements, bids, or proposals will be due.

(ii) Establish reasonable qualification criteria and standards.

(iii) Award the subcontract either on a best value basis or to the lowest responsible bidder. The process may include prequalification or short-listing. The process shall not apply to subcontractors listed in the original proposal. Subcontractors awarded construction subcontracts under this subdivision shall be afforded all the protections of the Subletting and Subcontracting Fair Practices Act (Chapter 4 (commencing with Section 4100) of Part 1 of Division 2 of the Public Contract Code).

(5) Nothing in paragraph (2) shall preclude a school district from segregating the request for proposals into a request for qualifications, followed by a request for proposals with price information from the proposers deemed most qualified by the school district, provided that the procedures specified in paragraphs (2), (3), and (4) are otherwise followed.

(b)(1) Notwithstanding Sections 17297 and 17402, for purposes of utilizing preconstruction services, a school district may enter into an instrument created pursuant to paragraph (1) of subdivision (a) before written approval by the Department of General Services' Division of the State Architect only if the instrument provides that no work for which a contractor is required to be licensed in accordance with Article 5 (commencing with Section 7065) of Chapter 9 of Division 3 of the Business and

Professions Code and for which Division of the State Architect approval is required can be performed before receipt of the required Division of the State Architect approval.

(2) Nothing in this subdivision waives the requirements of Section 17072.30 or Section 17074.16, or any other applicable requirements of Chapter 12.5 (commencing with Section 17070.10) of Part 10.

(c) A rental of property that complies with subdivision (a) as it reads on the day that the lease is entered into shall be deemed to have thereby required the payment of adequate consideration for purposes of Section 6 of Article XVI of the California Constitution.

(d)(1) This subdivision shall apply to a project for the construction, alteration, repair, or improvement of any structure, building, or other improvement of any kind that was leased through an instrument pursuant to this section before July 1, 2015. If at any time the instrument is determined to be invalid by a court of competent jurisdiction because it fails to fall within the competitive bidding exception pursuant to paragraph (1) of subdivision (a), as it read on December 31, 2016, the contractor who entered into the instrument with the school district may be paid the reasonable cost, specifically excluding profit, of the labor, equipment, materials, and services furnished by the contractor before the date of the determination

that the instrument is invalid if all of the following conditions, as determined by the court, are met:

(A) The contractor proceeded with construction, alteration, repair, or improvement based upon a good faith belief that the instrument was valid.

(B) The school district has reasonably determined that the work performed is satisfactory.

(C) Contractor fraud did not occur in the obtaining or performance of the instrument.

(D) The instrument does not otherwise violate state law related to the construction or leasing of public works of improvement.

(2) In no event shall payment to the contractor pursuant to this section exceed either of the following:

(A) The contractor's costs as included in the instrument plus the cost of any approved change orders.

(B) The lease payments made, less profit, at the point in time the instrument is determined to be invalid by a court of competent jurisdiction.

(3) Notwithstanding paragraph (1), this subdivision shall not affect any protest and legal proceedings, whether contractual, administrative, or judicial, to challenge the award of the public works contract, nor affect any rights under Section 337.1 or 337.15 of the Code of Civil Procedure.

(e) This section shall become inoperative on July 1, 2022, and, as of January 1, 2023, is repealed, unless a later enacted statute, that becomes operative on or before January 1, 2023, deletes or extends the dates on which it becomes inoperative and is repealed.[11]

[11] Davis makes no claim that Fresno Unified or Harris failed to comply with any of the requirements expressly set out in this statute.

B. The Claims Mistakenly Allowed by the Fifth District

1. "The Lease-leaseback Contract Must Be Financed by the Contractor."

In *Davis I*, the Court held that the Legislature's main purpose in allowing the lease-leaseback was to provide school districts with a new method of financing school construction, whereby the contractor (rather than the school district) could use his contract with the school district to obtain third-party financing for the project. *Id.* at 276–280. Because Fresno Unified was using its own funds (obtained from a bond issue approved by Fresno's voters) instead of third-party financing to be obtained by Harris, this lease-leaseback arrangement was invalid. *Id.* at 280.

Education Code section 17406 includes no such requirement. The statute is thorough and complete, dealing in detail with issues likely to arise regarding lease-leaseback contracts, while leaving the school district with considerable discretion to determine which terms of the contract will be in "the best interest of the school district", and which potential builder is most likely to provide the "best value" to the district.

The Legislature might well have *considered* other issues — including financing — during their deliberations. But for

whatever reason, they decided *not* to include them in the statute they finally enacted. The Legislature elected *not* to include any requirement that school districts use lease-leaseback only to enable contractors to provide financing.

The Legislature's chosen language best shows its intent, because "it is that language of the statute itself that has successfully braved the legislative gauntlet". *California School Employees Assn. v. Governing Board* (1994) 8 Cal.4th 333, 338. To *read into* this statute requirements *in addition to what the Legislature explicitly set out* would undermine the Legislative intent. "[I]f the legislature had intended otherwise, it would have said so." Sutherland, *Statutes and Statutory Construction* (7th Ed. 2020) § 46.1.

But such "reading into" is exactly what the Court of Appeal did in the present case. The Court held that the lease-leaseback arrangement was invalid because it did not require the contractor to seek third party financing for the project, which was instead financed by a local bond issue that had already been approved by the voters. No language regarding financing appears in the statute. The Legislature simply left it to the school district to determine how to finance the project.

Legislative history may be used to help interpret a statute's *ambiguous* language. *Davis I* mentions this rule at the outset of its analysis (237 Cal.App.4th at 275), but then proceeds to ignore it — citing no ambiguous language in the statute regarding financing.

McGee v. Balfour (2016) 247 Cal.App.4th 235, 244, refused to read additional requirements into Education Code section 17406. The court held that the lease-leaseback statute requires *only* that "the real property belong to the school district, the lease is for the purposes of construction, and the title shall vest in the school district at the end of the lease term." The court added: "Plaintiffs' efforts to engraft additional requirements—such as the timing of the lease payments, the duration of the lease, and the financing—are not based on the plain language of the statute." *Id.* at 244.

In a later *McGee* decision, the court expressly rejected the *Davis* reasoning. In *McGee v. Torrance, supra,* 49 Cal.App.5th 814, the court upheld that lease-leaseback arrangement *despite* the fact that the funds for the lease-leaseback had already been obtained through a bond issue — just as Fresno Unified had done:

> Here, the challenged lease-leaseback agreements were "funded through Torrance Unified School District General Obligation Bond Measure[s]." (See *McGee II, supra,* 247 Cal.App.4th at p. 240, 202 Cal.Rptr.3d 251 ["The contracts were awarded to Balfour and were funded through a general obligation bond."].) Thus, the lease-leaseback agreements involved the District's financial obligations and were inextricably bound up in the District's bond financing, *bringing them within* the scope of "contracts" covered by Government Code section 53511.
>
> [*McGee v. Torrance*, *supra*, 49 Cal.App.5th at 824; emphasis added.]

Davis's approach — searching for requirements that are not listed in the statute, and finding a financing requirement — was also rejected in *California Taxpayers Action Network v. Taber Construction, Inc.* (2017) 12 Cal.App.5th 115. In *Taber Construction*, the court held:

> Our conclusion is based on the plain language of section 17406. The statute has three requirements: "[1] the real property belong[s] to the school district, [2] the lease is for the purposes of construction, and [3] the title shall vest in the school district at the end of the lease term." (*McGee*, *supra*, 247 Cal.App.4th at p. 244, 202 Cal.Rptr.3d 251; § 17406, subd. (a)(1)) Here,

the lease-leaseback agreement between the School District and Taber, as alleged by plaintiff, meets these three statutory requirements. The School District owns the project sites, the agreement requires Taber to complete the construction project (HVAC modernization), and title vests in the School District at the end of the lease term. *Nothing more is required*. [*Id*. at 127; emphasis added.]

The court then *expressly* rejected *Davis I*:

> We decline to follow *Davis*, which went far beyond the language of section 17406 in adopting ill-defined additional factors to determine whether the leaseback portion of a lease-leaseback agreement is a "true" lease and imposing a requirement that the contractor provide financing for the project. Instead, we agree with *McGee*, which rejected *Davis* and declined to read additional requirements into section 17406. [¶]
>
> The *Davis* court relied on what it determined to be the intended purpose of section 17406 to impose requirements not expressed in the statute, but, as *McGee* observed, "our role is to interpret the language of the statute, not to rewrite the statute." (*McGee*, *supra*, 247 Cal.App.4th at p. 244, 202 Cal.Rptr.3d 251.) "We may not, under the guise of interpretation, insert qualifying provisions not included in the statute." (*Estate of Griswold* (2001) 25 Cal.4th 904,

917 108 Cal.Rptr.2d 165, 24 P.3d 1191.)

[*Id.* at 129–130.][12]

The "plain language" doctrine relied on by *Taber Construction* is well established in California. In addition to *Estate of Griswold*, cited in the above quotation, see also *MacIsaac v. Waste Management Collection & Recycling, Inc.* (2005) 134 Cal.App.4th 1076, 1083 ("If the statutory language is clear and unambiguous, our task is at an end, for there is no need for judicial construction. In such a case, there is nothing for the court to interpret or construe"); *Whaley v. Sony Computer Entertainment America, Inc.* (2004) 121 Cal.App.4th 479, 486 (courts "may not 'insert qualifying provisions not included in the statute' "); and *Lazar v. Hertz Corporation* (1999) 69 Cal.App.4th 1494, 1503 (a court "may not speculate that the legislature meant something other than what it said, nor may [a court] require a

[12] See also *Los Alamitos Unified School District v. Howard Contracting, Inc.* (2014) 229 Cal.App.4th 1222, 1227, which also held that, to bring a validation action, a school district need show only three elements: the district owned the land, the contractor agreed to construct the project for a maximum price, and title would vest in the school district at the end of the lease. And two cases have held that Government Code section 53511 may be used where bond funds are "inextricably bound up with the award of contracts". See *McLeod, supra,* 158 Cal.App.4th at 1168; and *Graydon, supra,* 104 Cal.App.3d at 645–646.

statute to make express an intention that did not find itself expressed in the language of that provision").

And this is the rule across the country. As a noted treatise on statutory interpretation explains: " 'There is no safer nor better settled canon of interpretation than that when language is clear and unambiguous it must be held to mean what it plainly expresses,' * * * * The intent of the authors of legislation is gleaned from what is said, not from what they may have intended to say. * * * * Courts are not free to read unwarranted meanings into an unambiguous statute, even to support a supposedly desirable policy not effectuated by the act as written." [Sutherland, *Statutes and Statutory Construction* (7th Ed. 2020) § 46.1 (footnotes omitted)]

Application of the plain meaning rule is especially appropriate in the instant case. Most of the amicus letters submitted in support of the petitions for review were signed not by lawyers, but by school district officials. And many of them were "me-too" letters that supported longer letters that were drafted by counsel retained by larger districts. Many of these letters came from smaller districts that are unable to retain lawyers on a full-time basis, and who must expect their non-

lawyer officials to read and understand a statute — but *not* to perform a lawyer's task of studying the legislative history behind the statute, as the *Davis* court did. It is simply unfair and bad policy to bind school districts to requirements that do not appear on the face of an enabling statute, when the consequences of an error might lead to the loss of millions of dollars in construction and litigation costs.

2. "The Lease-leaseback Contract Is Invalid If It Fails to Require the School District to Occupy the Property During the Lease."

In *Davis I,* the Court also concluded that the lease from Harris to Fresno Unified (the "Facilities Lease") was invalid, because it was "not a true lease", as it did not provide for Fresno Unified's occupancy of the school during the lease. Therefore, the Facilities Lease violated the competitive bidding provisions of the Education Code. *Id.* at 287–289.

Here again, the plain language of Education Code section 17406 includes no such requirement, and no opinion other than *Davis I* has ever imposed such a requirement. This Court should now hold that there is no such requirement.

3. "The Lease-leaseback Contract Must Include Competitive Bidding."

In *Davis I*, the Court of Appeal expressed concern that a lease-leaseback contract avoided the usual competitive bidding requirement. See 237 Cal.App.4th at 279–280.

However, in *Los Alamitos Unified School District v. Howard Contracting, Inc.* (2014) 229 Cal.App.4th 1222, the court held that the Education Code exempts lease-leaseback contracts from competitive bidding. See also *California Taxpayers Action Network v. Taber Construction, Inc.* (2017) 12 Cal.App.5th 115, 130–131.

In any event, the *Davis* court made no mention of the fact that Education Code section 17406 requires a type of competitive bidding *within* the process of selecting a lease-leaseback contractor. See *id.* at 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."

4. "The Challenger May Seek to Invalidate the Lease-Leaseback Contract Even After the School Construction Is Completed."

In *Davis II*, the Court of Appeal held that because the lease-leaseback agreement with Harris did not include a financing element, it was not a "contract" subject to validation, and therefore "we conclude the contracts do not fall within the ambit of Government Code section 53511 and California's validation action. It follows that Davis may pursue a taxpayer's action seeking the remedy of disgorgement." *Id*. at 917; see also *id*. at 941–942. The Court held that "Disgorgement qualifies as effective relief, and, therefore, the taxpayer's action part of this lawsuit is not moot." *Id*. at 917.

Thus, because the Court had earlier held that the lease-leaseback arrangement was invalid, Davis may now pursue his "taxpayer's" claim that Harris must now disgorge the entire $36,702,876 (minus the $651,501 Harris already returned) to

Fresno Unified — even though Harris has already paid the bulk of those funds to subcontractors and employees.[13]

The *Davis II* opinion directly conflicts with another published Court of Appeal opinion: *McGee v. Torrance, supra,* 49 Cal.App.5th 814.

In *Davis II,* the Court of Appeal noted that disgorgement is *not* allowed in a reverse validation action. "Injunctive relief or an order compelling restitution to the public agency of all money unlawfully paid are not authorized by the validation statutes." *Davis II*, *supra*, 57 Cal.App.5th at 929. But the Court held that disgorgement *is* allowed in Davis's separate *taxpayer's* claim — even though the project had already been completed, and even though Davis failed to seek an injunction stopping it. The Court rejected Harris's argument that disgorgement is not a proper remedy where the plaintiff fails to seek an injunction stopping work on the project:

> This argument might have been relevant if Davis's lawsuit was exclusively a reverse validation

[13] In 2016, Education Code section 17406 was amended to provide that any disgorgement is limited to the contractor's profits. In the present case, however, Davis apparently contends that this limitation is not retroactive and does not apply to Fresno Unified's 2012 agreement with Harris.

> action. However, in the context of a taxpayer's action, "the fact that [the plaintiff] could have enjoined the illegal expenditure does not prevent [him] seeking to recover on behalf of the [local agency] monies illegally expended." (59 Cal.Jur.3d, *supra*, Taxpayers' Actions, § 7, pp. 192–193 [restoration of public funds], citing *Osburn v. Stone, supra*, 170 Cal. 480, 150 P. 367.) Here, we have determined the Construction Contracts (1) "did not include a financing component" (*Davis I, supra*, 237 Cal.App.4th at p. 291, 187 Cal.Rptr.3d 798); (2) are not "contracts" for purposes of Government Code section 53511; and (3) are not subject to validation under the validation statutes. Consequently, the policy concerns applicable to contracts subject to validation do not apply to the Construction Contracts. (Cf. *Wilson, supra*, 191 Cal.App.4th at pp. 1580–1581, 120 Cal.Rptr.3d 665.) As a result, defendants' criticism of Davis for failing to obtain an injunction stopping construction of the middle school is not a ground for concluding the remedy of disgorgement is unavailable in the taxpayer's action.
>
> [*Id.* at 944.]

However, in another published opinion decided just a few months before *Davis II,* the court held just the opposite. *McGee v. Torrance, supra,* 49 Cal.App.5th 814, involved virtually the same

facts as *Davis II*. Just as Davis did, McGee brought a "reverse validation" action to invalidate a lease-leaseback contract, together with a separate "taxpayer's" claim based on conflict of interest. Just like Davis, McGee failed to seek an injunction to stop the project. Just as in *Davis II,* the project was completed, so the trial court held that the reverse validation action was moot. And just as Davis did, McGee claimed the right as a taxpayer to seek disgorgement under his related cause of action. The trial court disagreed, and the Court of Appeal affirmed:

> As in *Wilson* [*Wilson & Wilson v. City Council of Redwood City* (2011) 191 Cal.App.4th 1559, 1579], McGee's reverse validation action was rendered moot by the completion of the challenged projects. McGee filed his first lawsuit as far back as 2013, and the trial court did not dismiss the cases until 2019. During those six years, McGee did nothing to stop the projects from moving forward while the validity of the lease-leaseback agreements was litigated. He tries to explain that choice by claiming he did not want to "impair District's ability to operate" and he had an "adequate remedy at law" through disgorgement. Even if true, that does not change the fact that the projects were completed. As *Wilson* recognized, this years-long delay destroyed the very purpose behind the

validation statutes—"to settle *promptly* all questions about the validity of an agency's action." (*Wilson, supra,* 191 Cal.App.4th at p. 1580, 120 Cal.Rptr.3d 665, italics added.) Having sought no stay or injunction, he is in no position " 'to complain of the very change in circumstances that [he] might have prevented by seeking such relief.' " (*Id.* at p. 1581, 120 Cal.Rptr.3d 665.)

[*McGee*, *supra*, 49 Cal.App.5th at 823.]

The Court then held that McGee's taxpayer claim was really a claim that the lease-leaseback arrangement was invalid. *Id.* at 824–825. The implications of this claim were serious, threatening to undermine the very purpose of the validation process:

> [A]ny judgment ordering disgorgement would *require* a finding the lease-leaseback agreements were void. In other words, the agreements would *necessarily* be invalidated.
>
> A judgment in McGee's favor would also undermine the very purpose behind the validation statutes. A cloud has hung over the challenged projects for *years*, destroying any hope in prompt validation of the underlying lease-leaseback agreements. That delay is largely attributable to McGee, who strategically chose not to prevent the

> projects from moving forward. Beyond the specific projects here, a judgment in McGee's favor would threaten *future* projects with the prospect of lawsuits long after completion. That would undoubtedly inhibit the District's ability to obtain financing for them. (See *Friedland* [*v. City of Long Beach* (1998) 62 Cal.App.4th 835] *supra,* 62 Cal.App.4th at p. 843 ["A key objective of a validation action is to limit the extent to which delay due to litigation may impair a public agency's ability to operate financially."].) " '[T]he essential difference between those actions which ought and those which ought not to come under [the validation statutes] [is] *the extent to which the lack of a prompt validating procedure will impair the public agency's ability to operate.* The fact that litigation may be pending or forthcoming drastically affects the marketability of public bonds' " and likely would have " 'a chilling effect upon potential third party lenders, thus resulting in higher interest rates or even the total denial of credit.' " (*McLeod* [*v. Vista Unified School Dist.* (2008) 158 Cal.App.4th 1156)
>
> [*Id*. at 828.]

McGee's holding is *directly contrary* to the holding in *Davis II*, which held that Davis's *taxpayer* action was *separate* from his reverse validation action, and therefore disgorgement was

allowed. This Court should now hold that *McGee* — not *Davis II* — states the correct rule.

CONCLUSION

California now faces a severe shortage of new school construction. Older schools are deteriorating and need replacement. "California's public schools serve more than 6 million students at 10,000-plus schools in more than 300,000 classrooms — 70% of which are more than 25 years old."[14]

The Legislature has recognized this in Education Code section 17001(a), which provides: "The Legislature hereby declares that it is in the interest of the state and the people thereof for the state to reconstruct, remodel, or replace existing school buildings that are educationally inadequate or that do not meet present-day structural safety requirements ... ."

To help carry out this intent, this Court should hold that:

1. Lease-leaseback contracts are "intertwined" with bonds subject to temporary arbitrage, and therefore the validity of such lease-leaseback contracts may be determined under our validation statutes.

[14] https://www.ppic.org/publication/bonds-for-k-12-school-facilities-in-california/

2. Under Education Code section 17406, a lease-leaseback contract is valid if it meets the requirements that appear on the face of the statute — the real property belongs to the school district, the lease is for the purposes of construction, and the title shall vest in the school district at the end of the lease.

Respectfully submitted,
Moskovitz Appellate Team

Date: May 13, 2021

/s/ Myron Moskovitz
By: Myron Moskovitz
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Harris Construction Co., Inc.

CERTIFICATE OF WORD COUNT

I hereby certify that the attached Opening Brief on the Merits, including footnotes, contains 11,727 words, according to the word count indicator on my Microsoft Word program.

Date: May 13, 2021

/s/ Myron Moskovitz

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Supreme Court of California
Jorge E. Navarrete, Clerk and Executive Officer of the Court
Electronically FILED on 5/13/2021 by Florentino Jimenez, Deputy Clerk

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Supreme Court of California

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5/13/2021

Date

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