

Lease-Leaseback School Construction Contracts Questioned By Appellate Court

By: Tim Truax, Law Offices of Timothy M. Truax PC, 6/5/2015

Contractors building California public school projects utilizing a lease-leaseback (LLB) arrangement with a local school district should immediately evaluate a recent appellate opinion and its potential impact on their own situations.

On June 1, 2015, the Fifth District Court of Appeal issued its opinion in Davis v. Fresno Unified School District, ruling that a taxpayer had adequately alleged that the Education Code provisions permitting LLB arrangements did not apply to situations where it was alleged:

- (1) the agreement was not a genuine lease but simply a traditional construction agreement;
- (2) the agreement did not include a financing component for the construction of the project; and
- (3) the arrangement did not provide for the district's use of the new facilities "during the term of the lease."

The court also ruled that the taxpayer had adequately alleged that the contractor's preconstruction services for the district may be a conflict of interest under the Government Code because the contractor was arguably a district "employee" with a financial interest in the LLB contract.

The ramifications for contractors whose LLB arrangements are similar to those stated in Davis could be devastating. In Davis, the plaintiff taxpayer seeks to recover from the contractor nearly \$37 million paid to it under what the taxpayer alleges was a void contract.

It is important to note that this decision is not final, and still may be reviewed by the California Supreme Court. Moreover, the court has only ruled that the allegations are legally sufficient; the case now will go back to the trial court for a ruling whether the Fresno LLB arrangement meets the requirements of California law, and the proper remedy if it does not.

In addition, the court in Davis said if the district had filed a "validation action" seeking the approval of its LLB arrangement, the taxpayer lawsuit could not have gone forward. Many school districts only execute LLB contracts after having filed and prevailed in such a validation action.

The issues raised by the Davis decision have been considered many times by the AGC Legal Advisory Committee. Look for a more detailed analysis of the law on LLB arrangements, the Davis decision, and best practices for contractors, in an upcoming Legal Brief.

In addition, the AGC Legislative Committee has considered multiple suggestions for revisions to the LLB statutes in the past few years. It is expected this decision will cause more legislative proposals to surface. As always, AGC will look to protect contractors – both those who utilize LLB contracts and those who prefer competitive bidding – so that all concerned know the rules and can follow them, and aren't unfairly penalized when a school district violates those rules.

If you have questions about the Davis decision or its effect on your company's situation, please contact John Hakel, VP of Government Relations at (626) 608-5800 or hakelj@agc-ca.org.

Truax, Tim. "Lease-Leaseback School Construction Contracts Questioned By Appellate Court." AGC California. Associated General Contractors of California, 05 June 2015. Web. 14 Sept. 2015. <<http://www.agc-ca.org/newslisting.aspx?id=14096>>.