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File 1489.001

July 30, 2015

VIA OVERNIGHT DELIVERY

The Honorable Tani Gorre Cantil-Sakauye
Chief Justice
The Honorable Kathryn M. Werdegar
Associate Justice
The Honorable Ming W. Chin
Associate Justice
The Honorable Carol A. Corrigan
Associate Justice
The Honorable Goodwin H. Liu
Associate Justice
The Honorable Mariano-Florentiono Cuéllar
Associate Justice
The Honorable Leondra R. Kruger
Associate Justice
Supreme Court of the State of California
350 McAllister Street
San Francisco, California 94102-4797

Re: *Stephen K. Davis*
v. Fresno Unified School District, et al.
Court of Appeal Case No. F068477
Request for Depublication

Dear Honorable Chief Justice and Associate Justices:

Pursuant to Rule of Court 8.1125, the Associated Builders and Contractors of San Diego, Inc. (ABC San Diego), requests depublication of the opinion filed on June 1, 2015, by the Fifth Appellate District Court in *Stephen K. Davis v. Fresno Unified School District et al.*, (*Davis*), as modified (June 19, 2015), review filed (July 14, 2015).[1] In *Davis*, the Appellate Court created requirements for "lease-leaseback" school construction contracts which are not part of the authorizing statute, Education Code section 17406. Not only did the Court create requirements without statutory authority, the requirements it set are hopelessly vague. The Appellate Court provided no guidance on such things as what financing or lease term will satisfy the undefined requirements. Thousands of school construction projects awarded by districts across the State and amounting to billions of dollars of school spending have been awarded via

[1] Should the Court deny this request for depublication, ABC San Diego requests the Court accept the Petitions for Review filed by Fresno Unified School District and Harris Construction Co. Inc. This request will be further discussed in ABC San Diego's *amicus curiae* letter in support of Supreme Court review.

Education Code section 17406. The Appellate Court's internally inconsistent and hopelessly vague opinion turns the world of school construction on its head. Further, the *Davis* court improperly expanded the scope of Government Code section 1090. The great weight of authorities established by the statute does not apply to independent contractors.

The issues that were raised by Mr. Davis in the underlying lawsuit would properly be the subject of legislative revision, if the legislature believes change is needed. However, these statutes should not be rewritten by an appellate court. In regard to both Education Code section 17406 and Government Code section 1090, the Appellate Court disregarded or added to the plain language of the statute to create its own requirements. The opinion should be depublished because it misstates the law regarding Sections 17406 and 1090 and will only cause confusion among contractors, school districts, and courts.

I. ABC SAN DIEGO'S INTEREST IN THIS CASE

ABC San Diego has an interest in this matter because the *Davis* decision affects school construction throughout California. ABC San Diego is part of Associated Builders and Contractors, a national trade association representing nearly 15,000 contractors, subcontractors, material suppliers and construction-related professionals in 72 chapters across the United States. The association's membership includes all specialties within the industry, including school construction. ABC San Diego promotes growth in the construction industry and provides apprenticeship and safety training throughout Southern California. Currently, ABC San Diego has 1,000 members. These members include subcontractors and suppliers who provide services and equipment to lease-leaseback construction projects. Publication of the *Davis* decision threatens the very existence of these businesses.

The ramifications of the decision are potentially devastating. The decision has and will lead to further challenges to lease-leaseback contracts because of new "requirements" created by the Appellate Court. Hundreds of school districts throughout the State have used the lease-leaseback project delivery method to deliver billions of dollars of school facility construction and improvements. These districts and ABC San Diego members working on these projects have relied on the language of Education Code section 17406 and Government Code section 1090 in structuring their transactions in strict compliance with the requirements of the law and in good faith. The *Davis* decision and its new requirements to Section 17406 and expansion of Section 1090 put billions of dollars in construction at risk. As a result of the *Davis* decision, many projects have not been built during the critical 2015 summer break when school districts have only limited time to schedule construction work. Further, the *Davis* decision threatens the ability of subcontractors and suppliers to receive payment for work being performed on ongoing lease-leaseback projects. *Davis'* new requirements may cause certain school districts to stop payments for work performed. California law protects subcontractors and suppliers who provide labor and materials to public works projects through statutorily required payment bonds. However, the *Davis* decision threatens the enforceability of such bonds as sureties will likely claim the bonds are void if the underlying prime contracts are void.

In addition to the severe economic losses to contractors from current work, the *Davis* decision also means contractors, subcontractors, and suppliers will be facing claims for disgorgement for doing what they believed, in good faith and in reliance on multiple court judgments, they were legally entitled to do.

Claims against lease-leaseback contracts seek disgorgement of all amounts paid to contractors under the contracts, regardless of the fact that school districts received new school facilities at fair value. If disgorgement claims are brought against ABC San Diego members, many will be forced out of business.

II. THIS COURT SHOULD DEPUBLISH *DAVIS* BECAUSE THE DECISION IS BASED ON INCOMPLETE, INCONSISTENT ANALYSIS AND ONLY CREATES CONFUSION

This Court should depublish *Davis* for at least three reasons: (1) the Appellate Court's interpretation of Section 17406 is incomplete, inconsistent with the statute itself, and conflicts with existing case law; (2) the Appellate Court failed to provide meaningful guidance as to how contractors, subcontractors, suppliers, school districts, and courts should address future lease-leaseback contracts; and (3) the decision improperly expands the definition of "employee" under Section 1090.

1. *Davis* Rewrites Section 17406 In Conflict With The Statutory Language And Existing Case Law

Under the plain language of the Section 17406 subdivision (a), a valid lease-leaseback instrument only requires: (a) the district own the land to be leased to the builder; (b) the instrument by which the property is let to the builder must require the builder to construct a building or buildings on the land for the district's use; and (c) the instrument must provide that title to the buildings shall vest in the school district at the end of the term, although the instrument may provide for other means or methods by which title shall vest prior to the expiration of the term. (Ed. Code, §17406, subd. (a).)

The commonly used name, "lease-leaseback," refers to the agreement's structure:

(1) A site lease, for a minimum rent of one dollar a year, by the district to the contractor;
(2) A sublease or "facilities lease" by the contractor, back to the district, as a mechanism for payment; and
(3) A construction services agreement setting forth the improvements to be constructed (sometimes included as part of the sublease).

(See *Los Alamitos Unified School District v. Howard Contracting, Inc.* (2014) 229 Cal.App.4th 1222, 1224; *Davis v. Fresno Unified School District* (2015) 237 Cal.App.4th 261.) *Los Alamitos* and *Davis* confirmed that no portion of the lease-leaseback contract must be competitively bid. (*Los Alamitos*, *supra*, 229 Cal.App.4th at pp. 1227, 1229.)

Despite the clear language of Section 17406 and the Appellate Court decision in *Los Alamitos*, the *Davis* court inserted its own interpretation of Section 17406 without statutory authority. *Davis* decided that the lease-leaseback instrument must be a "genuine lease," which it further determined required a financing component and a period during the term of the lease where the district occupies the project for "school operations." (*Davis*, *supra*, 237 Cal.App.4th at pp. 280, 287.) However, *Davis* did not establish a

minimum lease term or even discuss how long the lease must last. It gave no guidance. (See *Id.* at pp. 288-289.) Likewise, *Davis* did not establish any minimum amount of financing. Again, it gave no guidance. (*Ibid.*)

Ironically, the Appellate Court acknowledged that "[w]hen statutory language is clear and unambiguous... courts adopt the literal meaning of the language ... ." (*Davis, supra*, 237 Cal.App.4th at p. 275, citation omitted.) Yet, when faced with the clear and unambiguous plain language of Section 17406, the Court failed to follow this rule and decided to "amend" Section 17406 to include new terms and requirements based on what the Court believes a "genuine" lease requires. This is also contrary to the Legislature's direction that an instrument under Section 17406 "shall contain other terms and conditions as the governing board may deem to be in the best interest of the school district." (Ed. Code, §17406, subd. (a).) Instead, the *Davis* court now requires that instruments under Section 17406 contain terms and conditions the Fifth Appellate District Court believes are appropriate.

The Court also referenced the value of legislative intent in analyzing statutory language. (*Davis, supra*, 237 Cal.App.4th at p. 275, citation omitted.) In fact, the Appellate Court discussed the supposed legislative intent and purposes of Section 17406 in great detail. (*Id.* at pp. 276-285.) However, the Court did not cite a single piece of legislative history as support. Worse yet, in Footnote 12, the Court admitted its disregard for actual legislative history: "Our review of legislative history did not uncover any material useful in deciding the questions of statutory interpretation presented by this case. Consequently, we did not take judicial notice of any legislative history on our own motion." (*Id.* at p. 285.)

The new requirements set forth in *Davis* are not supported by statutory language or legislative history. The Appellate Court's disregard for the clear language of the Section 17406 is contrary to established rules of statutory construction. (See *DiCampi-Mintz v. County of Santa Clara* (2012) 55 Cal.4th 983, 992; *Diamond Multimedia Systems, Inc. v. Superior Court* (1999) 19 Cal.4th 1036, 1047.) Publication of *Davis* would only encourage other courts to disregard statutory language. Presumably, courts could require "genuineness" of anything which could lead to a court's own "legislative" process of rewriting statutes. This is contrary to the law and policy of California.

2. <u>*Davis* Offers No Guidance To Contractors, School Districts, Or Other Courts</u>

Although *Davis* sets forth new requirements for Section 17406 transactions, it fails to provide guidance. *Davis* requires the school district to actually use the premises as a tenant for "school operations," but offers no guidance as to what this entails. What type of usage is required? How much usage is needed? Does an entire site need to be used? How long must usage be?[2] How must it be used? Is inspection of construction "school operations" use? Does use require instructional activities? Where does the term "school operations" come from? What usage constitutes "school operations?" These questions are specifically unanswered by *Davis*. Further, the *Davis* court did not provide any guidance on

[2] The statutory framework sets forth a maximum lease term of 40 years (Ed. Code, § 17403), but does not set a minimum. Clearly, the Legislature knew its intent in setting forth a maximum length, but not a minimum. The *Davis* decision sets an undefined, unknown minimum.

the newly required "financing" component to Section 17406. Similar questions exist. What type of financing is required? How much financing is needed? What interest rate should be applied? Can there be prepayment of the financing? How long of a term is required?

All these issues lead to one question – what are contractors, subcontractors, suppliers and courts supposed to do? There is no answer. Instead, the construction industry and courts will be forced to analyze lease-leaseback agreements through the nebulous lens of "what is a genuine lease." In reality, the statute already tells us. Publication of the *Davis* decision will undoubtedly lead to inconsistent verdicts with potentially disastrous results for contractors, subcontractors, and suppliers. Publication of opinions should explain and clarify law, not create further unanswered questions.

3. *Davis* Erroneously Expands Section 1090

Davis concluded that "the term 'employees' in Government Code section 1090 encompasses consultants hired by the local government," and thus, an independent consultant performing preconstruction services could violate Section 1090. (*Davis*, *supra*, 237 Cal.App.4th 261 at p. 300.) This conclusion is contrary to the language of the statute and should not be published.

First, with respect to the statute's plain language, Section 1090 uses the terms "officers and employees," but not the terms consultants or independent contractors. The common law rule is clear that an employee is different than an independent contractor or consultant. (See *Reynolds v. Bement* (2005) 36 Cal.4th 1075, 1086-1087.) "A statute will be construed in light of the common law unless the Legislature " " 'clearly and unequivocally' " " indicates otherwise. [Citation.]" (*Ibid.*) (*Green v. State* (2007) 42 Cal.4th 254, 260; *People v. Shabazz* (2006) 38 Cal.4th 55, 67.) A court should not inject provisions that are clearly absent, nor should it strain to use words in a sense other than their ordinary meaning. (Code Civ. Proc., § 1858; *Kobzoff v. Los Angeles County Harbor/UCLA Medical Center* (1998) 19 Cal.4th 851, 861; *Security Pacific National Bank v. Wozab* (1990) 51 Cal.3d 991, 998.) In Section 1090, the Legislature did not clearly indicate employee should be interpreted to include nonemployees.

Notably, in 1963, the same year it amended Government Code section 1090 to add the term "employees," the Legislature adopted Government Code section 810.2. Section 810.2 states: "'Employee" includes an officer, judicial officer as defined in Section 327 of the Elections Code, employee, or servant, whether or not compensated, but does not include an independent contractor." (Emphasis added.) This section shows the Legislature is fully capable of being specific as to its use of terms and their application, and did not, in adding employees to Section 1090, intend to cover independent contractors and consultants. In fact, during the 2013-2014 legislative session, Assembly Bill 1059 was proposed to amend Section 1090 to add independent contractors. It died in committee, thus confirming the Legislature's intent.

The *Davis* decision creates an internal conflict in Section 1090. The Appellate Court concludes that the same statutory language of Section 1090 is construed differently in civil cases than in criminal matters. (*Davis*, *supra*, 237 Cal.App.4th at p. 300.) *Davis* does not address the rule that a statute may not have different meanings in criminal and civil contexts. (1 B.E. Witkin, California Criminal Law Introduction to Crimes § 29 (4th ed. 2012); *Harrott v. Cnty. Of Kings* (2001) 25 Cal.4th 1138, 1154; *United States v. Santos* (2008) 553 U.S. 507, 523.) Further, expansion of Section 1090 to independent

contractors is at odds with the Supreme Court's recognition that Section 1090 and related conflict of interest laws "deal with a relatively small class of people, public officers and employees ... ." (*Lexin v. Superior Court* (2010) 47 Cal.4th 1050, 1091, *as modified* (Apr. 22, 2010).) The *Davis* decision expands such laws to potentially all people who do business with public entities. Such expansion is not supported by any statutory language or legislative history.

The Appellate Court also ignores the "basic canon of statutory construction that statutes in pari materia should be construed together so that all parts of the statutory scheme are given effect." (*Lexin v. Superior Court* (2010) 47 Cal.4th 1050, 1090-91, *as modified* (Apr. 22, 2010).) Other statutory schemes show the Legislature did not intend Section 1090 to apply to consultants and independent contractors. For instance, the Legislature specifically addressed the question of preconstruction consulting services in 1990, when it enacted Public Contract Code section 10365.5, which is part of the State Contract Act and applies to contracts with the State of California. Section 10365.5 was enacted to prohibit those providing consultant services from entering subsequent contracts related to the consulting services unless an exception applies.[3] Section 10365.5 states:

> (a) No person, firm, or subsidiary thereof who has been awarded a consulting services contract may submit a bid for, nor be awarded a contract for, the provision of services, procurement of goods or supplies, or any other related action which is required, suggested, or otherwise deemed appropriate in the end product of the consulting services contract.
>
> (b) Subdivision (a) does not apply to any person, firm, or subsidiary thereof who is awarded a subcontract of a consulting services contract which amounts to no more than 10 percent of the total monetary value of the consulting services contract.
>
> (c) Subdivisions (a) and (b) do not apply to consulting services contracts subject to Chapter 10 (commencing with Section 4525) of Division 5 of Title 1 of the Government Code.

Section 10365.5 was only necessary because Government Code section 1090 does not apply to consultants bidding on subsequent, related work. If Section 1090 applied to the practice, then Section 10365.5 would not have been required.

This is supported by the legislative history of Section 10365.5. According to a digest in the assembly, existing law "prohibits any state officer or employee from contracting with any state agency to provide goods or services." (Digest, Assembly Committee on Governmental Efficiency and Consumer Protection, Assembly Bill 3285, April 4, 1990, p. 1.) "Under current law, contractors involved in the development of a capital outlay plan for the state are not covered by conflict of interest codes which would prevent them from bidding on that plan." (Background Information Request, Assembly Committee on Government Efficiency and Consumer Protection, assembly Bill 3285; See also Statement for AB 3285, April 16, 1990.) "The purpose of the bill, according to its author, is to ensure that contractors who develop a capital outlay plan are prohibited from bidding on the construction project. The author feels that a consultant who develops a capital outlay project could have an inherent advantage on a contract for

[3] Notably, subdivision (c) of Section 10365.5 exempts consultants providing preconstruction services from the prohibition.

the construction or operation of the project." (Digest, Assembly Committee on Governmental Efficiency and Consumer Protection, Assembly Bill 3285, April 4, 1990, p. 1.) The author of the bill asked the Legislative Counsel the following:

> Does any provision of state law prohibit a private firm which contracts with a state agency for consulting services in connection with the development of a capital outlay plan for the construction and operation of a veterans' home from thereafter contracting with the agency for the construction and operation of the home?

(See Ops. Cal. Legis. Counsel, No. 26011 (January 25, 1990) State Contracts: Consulting Services, p. 1.)

The opinion of the Legislative Counsel was as follows:

> There is no provision of state law which prohibits a private firm which contracts with a state agency for consulting services in connection with the development of a capital outlay plan for the construction and operation of a veterans' home from thereafter contracting with the agency for the construction and operation of the home.

(*Ibid.*) After analyzing existing conflict of interest rules, the Legislative Counsel concluded:

> Since we are dealing with a consultant under contract as opposed to an officer of employee ... neither of these provisions apply to the situation under consideration. Moreover, there are no similar provisions which do apply to consultants or to contractors generally.

(*Id.* at p. 3.) In a letter requesting the Governor's support for the bill, the author wrote:

> Currently, state law prohibits, with certain exceptions, former state employees from entering into contracts which they were involved with while employed by the state for a two-year period after leaving state employment. Current law also provides contract prohibitions with respect to current state employees. [Para.] Existing law does not address this issue with people who work for the state under consulting services contractors.

(Assemblyman Steve Clute, sponsor of Assem. Bill No. 3285 (1989-1990 Reg. Sess.), letter to governor, July 9, 1990.)

Obviously, the Legislature and the Legislative Counsel was aware of Government Code sections 1090 and 810.2 when taking these actions. The exceptions to Section 10365.5, subdivision (a) provide further insight on the Legislature's intended scope of Government Code section 1090. Of direct significance here, Subdivision (c) exempts from subdivision (a) any contract subject to Government Code section 4525. Government Code section 4525 governs contracts relating to the development, design, and construction of building projects, i.e., preconstruction services agreements. Thus, Public Contract Code section 10365.5 expressly allows a preconstruction consultant to contract for the building work. Again, including consultants within Government Code section 1090 would cause a conflict between the two statutes. Thus, reading the statutes to give meaning to both, it must be that preconstruction contracts do

not create a conflict covered by Government Code section 1090 prohibitions. Otherwise, Government Code section 1090 would prohibit what Public Contract Code section 10365.5 allows, and the two cannot be harmonized.

Subdivision (b) of Section 10365.5 is also important because the Legislature has provided that a consultant may be financially interested in a contract, so long as the value of the contract does not exceed 10 percent of the related original consulting contract. A 10 percent interest would not be allowed under Government Code section 1090. Thus, if consultants are properly included within the definition of "officers or employees" in Section 1090, the statutes would again be in direct conflict.

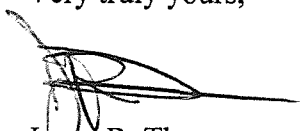
As further example, in 2012 the Legislature enacted Public Contract Code section 6700 et seq., which allows the California Department of Transportation to enter construction contracts through the Construction Manager/General Contractor method. Section 6703 specifically allows the public entity to enter a preconstruction services[4] contract with the construction manager. (Pub. Contract Code, § 6703, subd. (3).) Once project plans have been sufficiently developed, the construction manager and public entity are explicitly permitted to negotiate a price for and enter into a construction services contract. (*Id.*) *Davis'* misinterpretation of Section 1090 would render this entire legislatively proscribed process unlawful.

Considering the plain language of Government Code section 1090 in this light, as well as the clear definition in Section 810.2, along with the other procurement statutes, shows that the *Davis* decision is not supportable and should not be published as precedent.

III. CONCLUSION

The *Davis* decision only leads to uncertainty in application of Section 17406 and Section 1090. With no clear answers, ABC San Diego members and courts are left to guess what to do. Lawsuits will continue, claims for disgorgement will be sought, and many contractors face real risk of bankruptcy. Such ramifications should not be based on an appellate decision not grounded in the law. The Associated Builders and Contractors of San Diego, Inc., respectfully requests this Court depublish the opinion of *Stephen K. Davis v. Fresno Unified School District et al,* Court of Appeal Case No. F068477.

Very truly yours,



Jason R. Thornton,
Partner

JRT:dvg/38K5648

[4] "Preconstruction services" means advice during the design phase including, but not limited to, scheduling, pricing, and phasing to assist the department to design a more constructible project. (Pub. Contract Code, § 6702.)

PROOF OF SERVICE BY MAIL

I, Stacy M. Torres, declare that:

I am over the age of eighteen years and not a party to the action; I am employed in the County of San Diego, California; where the mailing occurs; and my business address is 4747 Executive Drive, Suite 700, San Diego, California 92121-3107. I further declare that I am readily familiar with the business' practice for collection and processing of correspondence for mailing with the United States Postal Service pursuant to which practice the correspondence will be deposited with the United States Postal Service this same day in the ordinary course of business. I caused to be served the following document(s): REQUEST FOR DEPUBLICATION, by placing a copy thereof in a separate envelope for each addressee listed as follows:

The Honorable Tani Gorre Cantil-Sakauye
Chief Justice
Supreme Court of the State of California
350 McAllister Street
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The Honorable Kathryn M. Werdegar
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/ / / / /

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I then sealed the envelope(s) and, with the postage thereon fully prepaid, either deposited it/each in the United States Postal Service or placed it/each for collection and mailing on July 30, 2015, at San Diego, California, following ordinary business practices.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on July 30, 2015.

Stacy M. Torres