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VIA ELECTRONIC MAIL ONLY

Mr. David G. Ackerman
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Re: *Proposed Legislation In Response To Davis*

Dear Dave:

This responds to your request for a summary of why the enclosed proposed legislation is needed and what it does.

1. What Is The Problem?

On June 1, 2015, the Court of Appeal of the Fifth District issued its opinion in *Davis v. Fresno Unified School District* concerning lease leaseback project delivery for public education. The Court's opinion:

(1) imposes requirements for lease leaseback contracts that are not found within the text of the authorizing statute (Ed. Code sec. 17406) or the legislative history;[1]

(2) is inconsistent with the decision of another appellate district and the opinion of at least three other trial courts. (*See, e.g. Los Alamitos School District v. Howard Contracting, Inc.* 229 Cal.App.4th 1222); and

(3) erroneously expands current conflict of interest laws to independent contractors engaged in providing valuable, tax-saving pre-construction services.

Hundreds of school districts throughout the State have used lease leaseback project delivery to deliver billions of dollars of school facility construction and improvements. (See California's Coalition for Adequate School Housing *amicus curiae* brief in support of lease leaseback construction attached at Tab 2.) Hundreds of contractors throughout the State have entered into these contracts with districts and built timely and on budget facilities under the lease leaseback delivery model. Agencies which use lease leaseback overwhelmingly opine that the delivery method produces successful projects that are on time and on budget and without claims. These districts and contractors, as well as the thousands of subcontractors and material suppliers working on these projects, have relied on the language of Education Code section 17406 in structuring their transactions in strict compliance with the requirements of the law

[1] Until recently, the California Department of General Services Website published a Project Delivery Option handbook which included lease leaseback as a project delivery option and indicated that financing was not required. This is directly contrary to the requirement imposed by the Court in *Davis*.

and in good faith. The *Davis* decision and its new requirements put billions of dollars in construction at risk. Currently, this means many projects will not be built during the critical 2015 summer break when school districts have only limited time to schedule construction work. Besides the economic losses to contractors, subcontractors, and labor, the stoppage of essential school projects will hurt communities, teachers, and students most of all.

The *Davis* decision also means contractors and subcontractors will be facing claims for disgorgement that, if successful, will put many out of business for doing what they believed, in good faith and in reliance on multiple court judgments, they were legally entitled to do. Such challenges may lead to a "death spiral" in the school construction industry. If disgorgement claims are brought against contractors, contractors will bring claims against subcontractors for amounts paid pursuant to the alleged unlawful contracts, forcing subcontractors to be put out of business, which in turn, leads to employee layoffs, pension fund shortfalls, and economic hardship for hardworking families. This result is beneficial for only one group - opportunistic lawyers. Fundamental fairness as well as thousands of well-paying local jobs require that contractors who built facilities using the lease leaseback delivery method not be put of business. *Davis* is not consistent with the existing law and is bad for school districts, contractors, subcontractors, suppliers, and trade labor.

In conjunction with California's Coalition for Adequate School Housing, the Associated General Contractors have worked to draft several legislative proposals that will protect school districts, contractors, subcontractors, employees who are working on, are about to undertake, or have completed lease leaseback projects. These proposals address the uncertainty created by the *Davis* decision.

2. Why Each Statutory Change Is Needed

A. Public Contract Code Section 5110

Existing law provides that contractors may recover their costs of performing construction work, not in excess of the contract sum and with no entitlement to profit, even if their contract is later determined to be legally invalid. Existing law is a compromise to protect contractors where a contract is found invalid due to some defect by a public entity. Public entities have approved thousands of lease leaseback contracts over the past decades. This proposed amendment clarifies and ensures that the existing protection under Section 5110 includes contracts issued through the lease leaseback delivery method. As addressed above, disgorgement of all amounts paid to contractors and subcontractors will only lead to bankruptcies, lawsuits, and layoffs. The legislation is necessary to protect contractors, subcontractors and workers who rely on the public agencies to award legal contracts.

B. Government Code Section 1090.2

Construction managers, program managers, design-assist contractors, and preconstruction services consultants have historically provided services, such as constructability review, value engineering, and similar services, to public entities in anticipation of participating in the actual construction work for which they had provided the prior preconstruction work. In performing their services, these independent contractors have never been found to be "[m]embers of the Legislature, state, county, district, judicial district, and city officers or employees" for purposes of conflict-of-interest provisions under Section 1090 of the Government Code. This has allowed the public entities to receive the benefit of preconstruction services in connection with their construction projects. This benefit results in timely and on budget government projects. (See Tab 2 for further discussion of the benefits to public entities.)

The proposed amendment clarifies existing law as no court has ever found the performance of preconstruction services creates a conflict for the performance of the work for which the pre-construction services were performed. This amendment does not immunize any corrupt practice.

C. Education Code Section 17406

The *Davis* decision inserts vaguely described "requirements" into Education Code section 17406 which are not in the statute, legislative history or in any government analysis of the statute (e.g. Attorney General or Department of General Services). This has created an unworkable situation where neither school districts nor contractors can be completely assured what is required for valid contracts. Such uncertainty threatens school construction, contractors, subcontractors and trade labor.

This amendment restates existing law and clarifies that the requirements created solely by the *Davis* decision (outside of the language of the statute) are not required for valid lease leaseback projects. This amendment ensures that school districts have the ability to negotiate and enter contracts which are in the best interest of the school district.

3. Conclusion

The three proposed statutory amendments clarify and state the current law and end the confusion, uncertainty, and unnecessary lawsuits created by the *Davis* decision. As with any law, future changes to lease leaseback can be made through separate legislation. However, we believe the current uncertainty makes passage of these proposed amendments an urgent matter that cannot wait until the next legislative session and cannot permit new changes to the current lease leaseback delivery method.

Without Legislative action, contractors, subcontractors, and their hardworking employees are threatened by the *Davis* decision. Several school districts have already stopped work – which we have tallied in excess of $100 million – that would have provided jobs this summer. The proposed amendments will end the uncertainty surrounding the *Davis* decision, will advance the interests of school districts, contractors, subcontractors, trade workers, and most importantly, the students who will be educated in the new school facilities built using lease leaseback.

Please contact us with any questions and if you require additional information.

Very truly yours,

P. Randolph Finch Jr.,
Partner

Enclosures

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