

1st Civil No. A145078

**IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA
FIRST APPELLATE DISTRICT, DIVISION 2**

CALIFORNIA TAXPAYERS ACTION NETWORK,

Plaintiff and Appellant,

vs.

TABER CONSTRUCTION, INC.;

MOUNT DIABLO UNIFIED SCHOOL DISTRICT,

Defendants and Respondents.

**AMICUS CURIAE BRIEF OF CALIFORNIA SCHOOL BOARDS
ASSOCIATION'S EDUCATION LEGAL ALLIANCE IN SUPPORT OF
DEFENDANT/RESPONDENT MOUNT DIABLO UNIFIED SCHOOL
DISTRICT**

On Appeal From the Superior Court for the State of California
Contra Costa County
Superior Court Case No. MSC 1400996
Honorable George V. Spanos, Judge Presiding

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I. INTRODUCTION

Amicus writes to provide the Court with practical information regarding the immediate and broad ranging impacts its decision will have on school districts throughout California. Additionally, Amicus writes to provide the Court with additional legal and factual information it may find helpful in rendering its decision.

Schools are granted broad authority under Ed. Code 17406 and 35061 to structure their agreements as they determine is in their own "best interest." Appellants' attack ignores and fails to show an abuse of this broad grant of discretion. Included in this broad grant of discretion is the ability for school districts to pay obligations made under Ed. Code § 17406 early. Even if *Davis v. Fresno Unified School District* (2015) 237 Cal.App.4th 261 [187 Cal.Rptr.3d 798], *as modified* (June 19, 2015), *review denied* (Aug. 26, 2015) ("*Davis*") is correct that a financing component is necessary (despite the fact Ed. Code § 17406 says nothing about financing) the ability to structure that financing is expressly left to the schools. Moreover, Appellants' arguments that Ed. Code § 17406 agreements must be bid ignores the fact that requiring bidding for such agreements would render portions of Ed. Code § 17062 meaningless.

As a practical matter, Amicus points out that school districts are *not* using Ed. Code § 17406 because there is a desire to *increase* project cost (or for nefarious purposes), they are doing so because they have determined it is in their best interest for a variety of reasons, including that competitively bidding the projects will not produce an advantage because it does not allow for true cost control.

Appellant's arguments that bidding is required for the "Facilities Lease" ignores the fact that Ed. Code § 17406 does not expressly require a facilities lease. If there is no requirement for a facilities lease, there can be no requirement that it be bid. The deal can be structured, as is stated in the statute, as each *district* determines to be in its "best interest."

II. ARGUMENT

A. On The Day The Decision In This Case Is Rendered, It Will Be Analyzed On Behalf Of Hundreds Of Schools And Will Affect School Facilities For Millions Of Students

According to the California Department of Education, approximately six million students in California attend public schools. (See, <http://www.cde.ca.gov/ds/sd/cb/ceffingertipfacts.asp>). K-12 school districts face a difficult challenge of providing adequate facilities for all of these students.

This challenge has been intensified due to the many questions left unanswered by the decision in *Davis*.

To provide the facilities required to meet the needs of their students, school districts have primarily either utilized Ed. Code § 17406¹ or the “*hard bid*” method authorized by Pub. Contract Code § 20111. While it is not possible to identify exactly how many school districts have utilized the provisions of section 17406, it has certainly been used by *hundreds* of school districts on *thousands* of projects. As an example of the prevalent use of section 17406, counsel for Amicus confirmed with the Los Angeles Unified School District that its “Lease-Leaseback” program has produced more than 70 projects since 2003, totaling more than \$2.7 billion in expenditures.

The *Davis* decision has created confusion for many school districts who simply wish to properly comply with the provisions of section 17406. Because the *Davis* decision went so far beyond the *language* of section 17406, it left many unanswered questions. As a result, school districts have been left to interpret the *Davis* decision at their own risk.² They need clarity on how they can use section 17406.

¹ All statutory references herein are to the California Education Code unless otherwise noted.

² The newly-created risk is not created by use of the lease-leaseback method itself, but is instead due to the uncertainty caused by the lack of clarity in the *Davis*

Given the widespread use of section 17406 in California, Amicus wishes to point out this case will have an immediate and extraordinary effect on hundreds of school districts and affect facilities provided to millions of students.

B. Public School Districts Are Granted Broad Discretion In Structuring Section 17406 Agreements, And Such Agreements Should Not Be Disturbed Absent Abuse Of Discretion

1. Ed. Code § 17406

Section 17406 contains *only* the following requirements:

- (1) a lease of real property belonging to the district for a minimum of \$1 in rent;
- (2) the lessee must construct, or provide for the construction of, building(s) on the premises for the use of the school district; and
- (3) title must revert back to the school district at the end of the lease term, and *may* provide for the vesting of title prior to the expiration of that term.

All other terms and conditions are *expressly* left to what the governing board, in its discretion, "*deem(s) to be in the best interest of the school district.*"

Ed. Code § 17406.

decision. Because *Davis* went so far beyond the statutory language, and created new requirements without legislative research or authority, *Davis* left many questions about what Districts *could* do under section 17406.

Coupled with this express delegation of discretion is the fact that school districts are vested by statute and the California Constitution to "act in any manner which is not in conflict with or inconsistent with ... any law." Cal. Const., Art. IX, § 14; Ed. Code § 35160. Thus, "[t]here is a correlative limitation upon the authority of courts to control the actions of local school districts ... courts should give substantial deference to the decisions of local school districts and boards within the scope of their broad discretion, and should intervene *only in clear cases of abuse of discretion.*" *Governing Bd. of Ripon Unified School Dist. v. Commission on Professional Conduct* (2009) 177 Cal.App.4th 1379, 1386 [99 Cal.Rptr.3d 903, 909]. (Emphasis in original.)

2. The Discretion Afforded Under Ed. Code § 17406 Is Apparent In Other Provisions Of Article 2, Which Anticipate The District's Discretion To Include Terms And Conditions Permitting Early Payment of Obligations

Ed. Code § 17406 is found within Ed. Code, § 17400 *et seq.* (hereinafter referred to as "Article 2.")

Ed. Code, §§ 17422, 17423 address how leases made under Article 2 must be calculated toward the district's outstanding bonded indebtedness.

For example, Ed. Code, § 17422 counts toward bonded indebtedness 50 percent of remaining payments for "use" of the "building" due from the district "under any leases and agreements entered into by the district pursuant to this

article, *if the leases and agreements were to run their full term ...*" In other words section 17422 anticipates a district being able to pay off its obligations early, in accordance with the terms of the lease or agreement, but requires that the duration of the full term of the agreement be used to calculate bonded indebtedness.

Similarly, Ed. Code, § 17423 creates a formula restricting use of Article 2 if 50 percent of amounts under leases or agreements made under Article 2 which would become due "*if the leases and agreements were to run their full term*" exceed certain thresholds. Again, the legislature anticipated districts being able to structure their own deals, including the ability to pay off their obligations early.

The legislature *expressly* left the discretion to the district to determine the terms that were "in its best interest" and *expressly* anticipated the district having the ability to pay off its obligations early.

3. The Discretion Afforded Under Section 17406, Ed. Code § 35160, And Anticipated By Sections Ed. Code §§ 17422, 17423, Is Contrary To Appellant's Interpretation of The Requirements Of *Davis*

Appellant interprets section 17406 and *Davis* to require an interest component and prohibit the exercise of an option to pay off obligations under a section 17406 agreement early. (See, Appellant's Reply at p. 34, seeking leave to amend to include these allegations). However, there is no mention in section

17406 of an "interest" requirement, *Davis* does not contain a requirement that interest be paid, and interpreting the law to prohibit districts from paying off their obligations early under section 17406 would contradict the fact that early payment is clearly contemplated by Ed. Code, §§ 17422, 17423. Appellant's interpretation is simply not based on law, it is based on their own non-expert opinions of what financing is and how it works. A loan with zero interest is still a loan.

C. If Ed. Code § 17406 Required Competitive Bidding, It Would Render Portions Of Ed. Code § 17062 Meaningless

Ed. Code §17062 provides: “(a) Notwithstanding Sections 20111 and 20118.4 of the Public Contract Code, or any other law, upon approval of funding pursuant to section 17061, a school district may utilize a request for qualifications and proposal process described in subdivision (a) of section 17061 to select and enter into a joint venture agreement with a developer to construct school facilities. The agreement may utilize section 17406.”

If competitive bidding were required for an agreement made pursuant to section 17406, this section would be meaningless, because it would *exempt* districts from competitive bidding which may be required under Pub. Contract Code § 20111 and then, in the next sentence, *require* competitive bidding under section 17406. Moreover, the practical implementation of section 17406 (discussed in section D(2) below) creates a more transparent process allowing the

district to understand the contractor's profit margins, and creates a more reliably accurate price estimate due to having fewer "change orders" and a guaranteed maximum price. Competitive bidding is not required for this reason, and the reasons discussed in *Los Alamitos Unified School District v. Howard Contracting, Inc.* (2014) 229 Cal.App.4th 1222, 1227 [178 Cal.Rptr.3d 355, 359], *review denied* (Dec. 10, 2014).

D. School Districts Do Not Use Section 17406 Because They Want The Projects To Cost *More*

1. Appellant's Preferred "Hard Bid" Method Sacrifices Actual Price Control For The *Illusion* Of Lowest Price

In "hard bid" projects under Pub. Contract Code § 20111, school districts are forced to contract with the lowest responsive, responsible bidder. In practice, the bidder who submits the lowest bid *wins*. Simply put, unless the bid is unusually irresponsible (or "non-responsive"), a district is stuck with the lowest bid it receives.

Districts use section 17406 because what actually happens is that contractors submit the lowest bid possible, and then submit "change orders" to increase the price of the project. (Pub. Contract Code, § 20118.4.) As a result of these "change orders," the *bid* price is never the *final* price, and the hard bid's objective of obtaining the *lowest* price is ironically lost.

2. Ed. Code §17406 Agreements Allow for Cost Control Through Subcontractor Bidding and Open-Book Accounting

In an Ed. Code §17406 agreement, a school district can obtain open access to the subcontractor bids, and openly negotiates the contractor's overhead and profit costs. By contrast, in a hard bid a district does not have any control over the contractor's profit margin. In an Ed. Code §17406 agreement, the district can obtain the subcontractor bids and negotiate every aspect of the price. As a result of subcontractor bidding and through the school district's ability to compare overhead and profit percentages with other contractors, a school has greater latitude to check and negotiate price fairness. Also, school districts use Ed. Code §17406 agreements to negotiate a "guaranteed maximum price" which allows districts to know and control the actual project cost when they enter into a contract.

School districts have no incentive to pay more for a project than is necessary. Governing board members are accountable to the public through elections, and are prohibited from participating in the ratification of contracts in which they have financial interest. (Gov. Code § 1090 et seq.) School districts' finance projects through local bonds are accountable to bond oversight committees. In short, hundreds of districts aren't using Lease-Leaseback because they want to pay more, they are doing it because competitive bidding is not creating an advantage for them. Courts have exempted public entities from competitive

bidding for this reason. See, *Graydon v. Pasadena Redevelopment Agency* (1980) 104 Cal.App.3d 631, 635 [164 Cal.Rptr. 56, 58].

E. There Is No Requirement To Bid The "Facilities Lease," Because Ed. Code § 17406 Does Not Require Two Documents

Appellant's arguments that the Facilities Lease must be bid ignores the fact that (as admitted by Appellant) Ed. Code § 17406 does not require a "Facilities Lease" at all. (Appellant's Reply, 13-14). Districts are certainly *permitted* by Ed. Code § 17406 to structure their agreement as a "facilities lease" if they determine it is in their "best interest," but it is not required. The fact that Ed. Code § 17406 "literally refers to only one instrument" as urged by Appellant does not mean that a second instrument is *required*, or that a second instrument must be bid.

F. The Plain Language Of Ed. Code § 17406 Should Be Honored

Districts have relied upon the will of the people as reflected in the plain language of Ed. Code § 17406 for decades. Parties dissatisfied with the state of the law are afforded a legislative mechanism for effecting change: vote. The voice of the electorate resulted in the enactment of Ed. Code §17406, and should not be ignored.

III. CONCLUSION

The trial court's ruling should be upheld for the reasons stated above.

DATED: December 14, 2015

Respectfully submitted,

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