Supreme Court No. _____

In the Supreme Court of the State of California

STEPHEN K. DAVIS,
Plaintiff/Appellant
vs.

FRESNO UNIFIED SCHOOL DISTRICT, et al.
Defendant/Respondent and Petitioner

After the Published Opinion in the Court of Appeal
Fifth District, Civil Case No. F068477

PETITION FOR REVIEW

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I. SUMMARY OF THIS PETITION

This case concerns "lease-leaseback" school construction contracts. The Court of Appeal's opinion and the issues presented by this petition impact hundreds of school districts and contractors who have participated, either currently or in the past, in hundreds of millions of dollars of lease-leaseback contracts on thousands of projects throughout the state.

Lease-leaseback is authorized by Education Code section 17406, subdivision (a), which allows a school district to lease land for a minimum of $1 to a contractor if the instrument by which the property is let requires the contractor to construct a building or buildings on the site for the use of the district during the term of the instrument, and provides that title to the building(s) vests in the district at the end of the term. The contractor is responsible for delivering the project at a fixed, "guaranteed maximum price," which allows the school district to know in advance and control the actual cost of the project. Section 17406(a) expressly exempts lease-leaseback arrangements from the competitive bidding requirements of Education Code Section 17417.[1]

[1] All statutory references are to the Education Code unless otherwise stated.

Petitioner Fresno Unified School District (FUSD) and Harris Construction Company, Inc. (Harris)[2] entered into a lease-leaseback contract in 2012[3] for the construction of a middle school in Fresno. The lease-leaseback arrangement between FUSD and Harris was structured exactly the same way as other school districts throughout California have structured their lease-leasebacks for years. The trial court read the plain language of section 17406(a) and found that the lease-leaseback between FUSD and Harris met the requirements of the statute, just as a number of Superior

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[2] Harris has filed its own petition for review, in which FUSD joins.

[3]Education Code section 17406, subdivision (a) provided in 2012: "Notwithstanding Section 17417, the governing board of a school district, without advertising for bids, may let, for a minimum rental of one dollar ($1) a year, to any person, firm, or corporation any real property that belongs to the district if the instrument by which such 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 thereof, 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 prior to the expiration of that term, and shall contain such other terms and conditions as the governing board may deem to be in the best interest of the school district."

Section 17406 was amended effective January 1, 2015 (Stats 2014 ch 408 § 1 [AB 1581]). As relevant here, the amendment added subdivision designation (a)(1); amended the first sentence of subd. (a)(1) by substituting "this property" for "such property," and "of the lease" for "thereof;" deleted "such" after "and shall contain" in the second sentence of subd. (a)(1).

Courts and the Second and Fourth District Courts of Appeal have concluded in upholding the other lease-leaseback arrangements.

However, in a published decision, the Fifth District Court of Appeal invalidated the lease-leaseback agreement between FUSD and Harris. Under the guise of "interpreting" section 17406(a), the Court of Appeal rewrote the statue to impose additional requirements not found in the plain language of the statute, thus creating a conflict between judicial districts. The court also left unanswered many questions about the additional requirements it imposed, leading to uncertainty for lower courts, school districts, and contractors throughout California.

The Court of Appeal also held that Harris, who had provided consulting services to FUSD, was an "employee" under Government Code section 1090, which prohibits state and municipal officers and employees from being "financially interested in any contract made by them in their official capacity, or by any body or board of which they are members." This holding is contrary to the Legislature's intent, violates established rules of statutory construction, and conflicts with the statutory exception for consultants who provide planning and project management services on state projects (Pub. Contr. Code section 10365.5(c)).

II. ISSUES FOR REVIEW

1. May a lease-leaseback arrangement be declared void for lack of competitive bidding because the lease was short-term rather than long-term, the school district did not use the improvements before the lease was terminated, and the district had fully paid for the improvements on completion of the project?

2. Does the term "employees" in Government Code Section 1090 include independent contractors and consultants?

III. STATEMENT OF THE CASE

On September 26, 2012, FUSD's board adopted a resolution to approve a lease-leaseback agreement with Harris for construction of a new middle school in Southwest Fresno. (1 AA 3, 26-29.) The guaranteed maximum price of the project was $36,702,876. (1 AA 54.) Completion was to be 595 days from the notice to proceed. (1 AA 66.)

The lease-leaseback agreement consists of two contracts – a Site Lease and a Facilities Lease. Under the Site Lease, FUSD agreed to lease the project site to Harris for $1 per year for the duration of the project. (1 AA 31-39.) Under the Facilities Lease (1 AA 41-112), Harris agreed to build the project on the site pursuant to the construction provisions attached as an exhibit to the Facilities Lease, and lease the site and the project back to FUSD. (1 AA 45.) FUSD agreed to pay Harris lease payments for the use

and occupancy of the project and the site, which covered the cost of construction as it was completed. (1 AA 46.) FUSD had the right to prepay the lease payments in full. (1 AA 47, 51.) The term of the Facilities Lease was from the date of signing to the date of completion. (1 AA 46.)

The Facilities Lease gave FUSD the right to use and enjoy the site and to take possession of the new facility as construction was completed during the term of the Facilities Lease. (1 AA 47.) The Facilities Lease provided FUSD would obtain title from Harris as construction progressed and corresponding lease payments were made, and upon full payment, title would be transferred to and vest in FUSD without further instrument of transfer. (1 AA 46-47.)

IV. PROCEDURAL HISTORY

On November 20, 2012, appellant Stephen K. Davis[4] filed a "reverse validation" complaint, pursuant to Code of Civil Procedure section 863, seeking to invalidate the lease-leaseback agreement.[5] (3 AA 551.) In

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[4] Davis filed this action allegedly as a "taxpayer" and "solely in the public interest" to recover to FUSD the funds it paid to Harris. (1AA 2.) But Davis is also a principal at Davis Moreno Construction, who was recently awarded a new portable classroom project with FUSD as the lowest bidder in a traditional hard-bid process. That project was originally intended to be a lease-leaseback agreement with another contractor until Davis won the appeal in this case. (Ex A to Motion for Judicial Notice.)

[5] Code of Civil Procedure section 860 provides that a public agency may commence an action to determine the validity of any matter, and for 60 days thereafter. If the public agency does not commence such an action, Code of [continued]

his operative first amended complaint,[6] Davis alleged causes of action against FUSD and Harris for (1) violation of the competitive bidding requirements of Public Contract Code section 20110 et seq. by entering into an improper arrangement that did not satisfy the criteria for the statutory exception in section 17406(a); (2) breach of fiduciary duty by FUSD's board; (3) failure to comply with the competitive bidding requirements of section 17417; (4) conflict of interest by Harris based on its participation in the planning and design of the project as a consultant to FUSD before the construction contracts were awarded; (5) improper use of section 17400 et seq. based on the legal theory that lease-leaseback arrangements are allowed only when used for financing school construction; (6) improper delegation of discretion; and (7) declaratory relief. (1 AA 1-21.)

Davis alleged the lease-leaseback agreement was illegal, void, and unenforceable because section 17406(a) requires the existence of a "genuine" lease of the property and improvements back to a school district,

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Civil Procedure section 863 allows any interested person to challenge the validity of the matter ("reverse validation") within 60 days. If no action is commenced by either the public agency or an interested person, the matter "self-validates" after 60 days. (*Los Alamitos Unified School District v. Howard Contracting, Inc.*, supra, 229 Cal.App.4th at 1231; *City of Ontario v. Superior Court* (1970) 2 Cal.3d 335, 341-342.)

[6] The District demurred and moved to strike portions of Davis's original complaint, and Davis elected to amend instead of opposing the motions. (1 AA 1-127; 3 AA 553-554.)

and there was no genuine leaseback here because FUSD made payments that lasted only as long as the duration of construction, varied based on the value of the work performed, and ended with the completion of the construction; and FUSD did "not have the right or practical ability" to use and occupy the property during the term of the Facilities Lease. (1 AA 8-9.) Davis also alleged the section 17406(a) exception can only be used by a school district to finance the cost of construction over time when sufficient immediate funds are not available, and therefore could not be used here because FUSD had sufficient immediate funds available from voter approved bond sales. (1 AA 17-18.)

Davis also sought to invalidate the lease-leaseback agreement under Government Code section 1090, which prohibits public officers and employees from being financially interested in any contract made by them in their official capacity.[7] Davis alleged that prior to being awarded the lease-leaseback agreements, Harris had served as a consultant to FUSD and assisted in the design and development of the project plans and specifications, which created a conflict of interest and precluded Harris from being awarded the project. (1 AA 16-17.)

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[7] Government Code section 1090, subdivision (a) provides in part: "Members of the Legislature, state, county, district, judicial district, and city officers of employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members."

FUSD and Harris demurred to the first amended complaint. (1 AA 130-152; 2 AA 277-302.) In support of its demurrer, FUSD filed a request for judicial notice (which Harris joined) that included copies of 22 default judgments entered between December 2010 and July 2012 in validation actions brought by school districts who used the same lease-leaseback arrangement for school construction and improvements in Los Angeles, Orange, Riverside, San Bernardino, Ventura, and Kern Counties. (2 AA 153, 174-262, 303-306.) The lease-leaseback agreements in those cases, as here, provided for (i) the lease of the property by the district to the builder, (ii) the acquisition and construction of the project, and (iii) the lease of the property and the project by the builder to the district. The default judgments state that the agreements "contain[ed] the information and showings required by Education Code Section 17406, ..." and that "[¶] Public Contract Code section 20111, which requires school districts to award construction contracts to the lowest responsible bidder," did not apply to the agreements. (2 AA 174-262.)

The trial court sustained FUSD's and Harris's demurrers to each of the seven causes of action in Davis's first amended complaint, with 30 days leave to amend. (3 AA 463-468.) The court ruled the lease-leaseback agreement met the requirements for application of section 17406, specifically, (1) FUSD must own the subject land, (2) there must be an agreement to construct a building on it for FUSD use, and (3) title in the

buildings must vest in FUSD at the end of the term. (3 AA 466.) The court also ruled financing was not required in order for a school district to use the lease-leaseback arrangement. (3 AA 466.) With regard to Davis's conflict of interest claim, the trial court ruled the first amended complaint failed to plead facts sufficient to establish that an employee of FUSD personally received a financial benefit due to the lease-leaseback arrangement. (3 AA 466.) After Davis failed to amend his complaint, the trial court entered judgment for FUSD and Harris, and Davis appealed. (3 AA 527-539, 540.)

V. THE COURT OF APPEAL'S OPINION

The Court of Appeal affirmed the trial court's ruling as to a number of Davis's cause of action but reversed as to others based on two theories. In a published opinion, the court held the section 17406(a) exception to competitive bidding applies only when the following are present:

First, there must be a "genuine" or "true lease" between the school district and contractor, and "more than a document designated a lease by the parties." (Modified Opinion 18, 20 [Attachment A].)[8] The court found Davis adequately alleged the Facilities Lease functioned more like a

[8] The Second District Court of Appeal expressly rejected this very same argument in *McGee v. Torrance Unified School District* (2015 Cal.App.Unpub. LEXIS 446), as an attempt by the taxpayer to "engraft additional requirements ... not based on any statutory language." (See discussion below, pgs. 15-16; Ex. B to Motion for Judicial Notice.)

traditional construction contract than a "genuine" lease. FUSD's monthly payments to Harris were based on the progress of construction, the final payment was due upon completion and acceptance of the construction, and once the final payment was made, both the Facilities Lease and the Site Lease terminated; whereas under a lease, payments are usually for a set time, such as monthly, during which the lessee occupies and uses the property. (Mod. Opn. 21-22, 27.)

Next, in order to be a "genuine" or "true" lease, the school district must actually use the newly built facilities, as a tenant, during the term of the lease. (Mod. Opn. 25, 26.) The Court of Appeal gave no guidance on how long a district must actually use the premises as a tenant, or the nature or extent of such use, in order to qualify as a "genuine" or "true" lease. (Mod. Opn. 26, fn. 13.) It found Davis adequately alleged the Facilities Lease did not satisfy this requirement because it did not provide for FUSD to use the newly built facilities during the term of the lease and FUSD acknowledged it did not occupy the school facility until the lease was terminated. (Mod. Opn. 4, 26 and fn. 13, 27.)[9]

Last, the lease-leaseback arrangement must include a financing component whereby the builder finances some or all of the

[9] This finding is contrary to the terms of the Facilities Lease, which gave FUSD the right to use and enjoy the site and to take possession of the new facility as construction was completed during the term of the Facilities Lease. (1 AA 47.)

construction cost. (Mod. Opn. 20.) The court gave no guidance as to the amount, duration, type, or terms of financing that is required. It found Davis adequately alleged the lease-leaseback arrangement between Harris and FUSD did not include a financing component for the construction of the project. (Mod. Opn. 27.)

On Davis's conflict of interest claim, the Court of Appeal held that Government Code section 1090, which applies to "officers or employees" of a school district or other public agency, includes corporate consultants of FUSD. The court found Davis adequately alleged that Harris, who had a prior consultancy contract with FUSD, met the statutory definition of a district "employee" for purposes of Government Code section 1090, and participated in the making of the lease-leaseback agreements. (Mod. Opn. 40.)

Neither FUSD nor Harris filed a petition for rehearing in the Court of Appeal.

VI. WHY THIS PETITION SHOULD BE GRANTED

A. The Issues are Important and of Statewide Interest

The opinion here has far-reaching consequences. Hundreds of school districts throughout California have used the lease-leaseback method in the same manner as it was used by FUSD on thousands of projects. (See

the CASH Amicus Brief that was filed in the Court of Appeal 1, 3-4, and Ex. A thereto [School Districts Who Have Used Lease-Leaseback].)

There are many advantages to the lease-leaseback project delivery method over the traditional hard-bid method. Foremost among them are that the Guaranteed Maximum Price mechanism in lease-leaseback allows the school districts to know in advance and control what the final price of a project will actually be, allows for cost control through subcontractor bidding and open-book accounting, allows for project timing that works with complicated school calendars, and allows for a collaborative project dynamic between the contractor and school district. (CASH Amicus Brief 5-9.)

The Court of Appeal's opinion invalidating the lease-leaseback agreement in this case, and imposing additional requirements not found in the plain language of section 17406(a), ignores the many advantages to lease-leaseback and is at odds with decisions from the Second and Fourth District Courts of Appeal upholding lease-leaseback arrangements on school district projects that were structured exactly the same as in this case. (See discussion below, pgs. 13-16.)

Moreover, the Court of Appeal's opinion broadly expanding the scope of Government Code section 1090 applies to all public agencies, not just school districts, and opens the door to potential scrutiny of all agency contracts with outside consultants in a variety of contexts. Its ruling

that once a company that has acted as a consultant on a project is thereafter barred from further work on that project will impair the ability of government entities to choose the best contractors to work on any particular project.

Efforts are being made to have the California Legislature amend certain statutes relating to school construction and conflict of interest in the wake of the Court of Appeal's opinion, thus demonstrating the statewide importance of these issues. (Ex. L to Motion for Judicial Notice.) However, passage of new legislation is not guaranteed, nor would it necessarily be swift. In the meantime, the opinion has created confusion and disparity of options in project delivery methods for school districts in different judicial districts, and dozens of lease-leaseback contracts involving hundreds of millions of dollars throughout the state are at risk for being invalidated.

Resolution of the questions presented by this petition will have significant consequences throughout California. Review by this Court is essential under California Rule of Court 8.500(b)(1) to settle these important questions of law.

B. The Court of Appeal's Opinion Conflicts with Decisions from Other Courts of Appeal Applying Section 17406(a)

The opinion conflicts with the decisions from the Fourth and Second District Courts of Appeal upholding lease-leaseback arrangements

that were structured exactly the same as in this case, and utilizing lease-leaseback agreements containing terms and conditions virtually identical to those here – *Los Alamitos Unified School District v. Howard Contracting, Inc.* (2014) 229 Cal.App.4th 1222 (*Los Alamitos*) and *McGee v. Torrance Unified School District* (2015 Cal.App.Unpub. LEXIS 446.)[10] (Exhibits C and D to Motion for Judicial Notice.)

Contrary to the Court of Appeal decision here, the Fourth and Second District Courts of Appeal found the language of section 17406(a) to be "plain, clear and unambiguous," with the Second District expressly stating in *McGee* that there was "nothing for the court to interpret or construe." (*McGee* Opn. 10 [Ex. B to Motion for Judicial Notice]; *Los Alamitos, supra*, 229 Cal.App.4th at 1228 (citing 56 Ops. Cal. Atty. Gen. 571, 581 [1973].) In upholding the lease-leaseback arrangements in those cases, both courts relied on the only requirements imposed by the statute – that the school district owns the land and leases it to the contractor, the contractor agrees to construct a building on the land for the use of the district, and title to the building vests in the district at the end of the term.

[10] We recognize the opinion in *McGee v. Torrance Unified School District* is unpublished. But we cite it because it demonstrates the prevalence and statewide importance of lease-leaseback in school construction, as well as the different treatment courts have given to the issues presented in this petition.

(*McGee* Opn. 10-11 [Ex. B to Motion for Judicial Notice] *Los Alamitos, supra*, 229 Cal.App.4th at 1227.)

Notably, in *McGee*, the plaintiff and school district were represented by the same attorneys who represent Davis and FUSD in this case, and the allegations and causes of action in McGee's first amended complaint are essentially verbatim of those in this case. (1 AA 1; Ex. C to Motion for Judicial Notice.) As in this case, the trial court sustained the school district's demurrer in *McGee*, and after plaintiff elected not to amend, entered judgment for the school district and plaintiff appealed. (Ex. E to Motion for Judicial Notice.) The plaintiff advanced every theory and argument on appeal in *McGee* as Davis made in this case; indeed, the appellate briefs (including those filed by amicus) filed in *McGee* and this appeal are carbon copies of each other down to almost every last word. (Exs. F, G, H and I to Motion for Judicial Notice.) But while the Second District Court of Appeal was not persuaded by plaintiff's arguments, the Court of Appeal here was.

The Second District specifically rejected plaintiff's argument, accepted by the Court of Appeal in this case, regarding "genuine" lease-leaseback transactions. The Second District found "no statutory basis to distinguish between 'genuine' and 'sham' lease-leaseback transactions" and that the plaintiff's "effort to engraft additional requirements are

unpersuasive because *they are not based on any statutory language*." (*McGee* Opn. 11, italics added [Ex. B to Motion for Judicial Notice].)

The Court of Appeal's opinion in this case is directly at odds with the *Los Alamitos* and *McGee* decisions. Whereas those courts relied on the "plain, clear and unambiguous" language of section 17406(a) to uphold the lease-leaseback arrangements, the Court of Appeal here erroneously applied a strict and narrow construction[11] of the statute to impose additional requirements not found in the language of the statute and to invalidate a lease-leaseback arrangement structured *exactly the same way*.

The current and conflicting state of the law creates confusion among courts, school districts, and contractors. Under Cal. Rule of Court 8.500(b)(1), this Court should grant review to resolve the conflict.

C. The Court of Appeal's Opinion is Inconsistent with the Plain Language of Section 17406(a)

The language in section 17406[12] is clear and unambiguous. Under the plain language of section 17406(a), a valid lease-leaseback arrangement requires only the following: the school district must own the land to be leased to the builder; the instrument by which the property is let

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[11] This was itself error. See discussion below, pgs. 20-21.

[12] The Court of Appeal's opinion is based on section 17406, as amended effective January 1, 2015, not the version of the statute as it read in 2012 when FUSD and Harris entered into the lease-leaseback agreement. (Mod. Opn. 15.) The word "lease" is not in the 2012 version of the statute. (See fn. 2, *supra*.)

to the builder must require the builder to construct a building or buildings on the land for the school district's use; and 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 the means or method by which title shall vest in the district prior to the expiration of the term. Moreover, the instrument may provide other terms and conditions that are in the district's best interest.

When the words of a statute are clear and unambiguous, the court's inquiry ends. (*Diamond Multimedia Systems, Inc. v. Superior Court* (1999) 19 Cal.4th 1036, 1047.) "[T]here is no need for construction, nor is it necessary to resort to indicia of the intent of the Legislature." (*DiCampi-Mintz v. County of Santa Clara* (2012) 55 Cal.4th 983, 992; *Delaney v. Superior Court* (1990) 50 Cal.3d 785, 800 ["When statutory language is thus clear and unambiguous there is no need for construction, and courts should not indulge in it .... This rule is deeply rooted in our jurisprudence."].)

The Court of Appeal violated these fundamental rules. Rather than applying the plain language of section 17406(a) as written, the Court of Appeal "indulged in construction" and rewrote the statute to read as it believed it should.

Specifically, the Court of Appeal rewrote section 17406(a) to require a "financing component," whereby the builder carries the cost of construction. This requirement finds no support in the plain language of the

statute or anywhere else within the statutory scheme.[13] If the Legislature intended to restrict the use of lease-leaseback only to situations when the builder finances the project, there are plenty of ways it could have made that restriction clear. A court may not "under the guise of interpretation insert qualifying provisions not included in the statute." (*Estate of Griswold* (2001) 25 Cal.4th 904, 917.) "In the construction of a statute ... the office of the judge is simply to ascertain and declare what is in the terms or in substance contained therein, not to insert what has been omitted or omit what has been inserted ...." (*Manufacturers Life Ins. Co. v. Superior Court* (1995) 10 Cal.4th 257, 274.)

Likewise, the Court of Appeal's requirement that FUSD must actually use the premises, as a tenant, during the term of the instrument finds no support in the plain language of the statute. The statute does not specify *any* particular "use" a school district must make of the premises, much less "in school operations," as the Court of Appeal found. (Mod. Opn. 24.) Moreover, both the 2012 and 2015 versions of Section 17406(a) state only that "*the instrument by which such property is let*" must *provide* certain things for the lease-leaseback arrangement to be valid. It is thus the terms

[13]The provisions authorizing school districts to enter into leases and agreements relating to real property are contained in Sections 17400-17429 of the Education Code. (Tit. 1, Div. 1, Pt. 10.5, Ch. 4, Art. 2.) Section 17402 requires a school district to have an available site and approved plans and specifications prior to entering into a lease or agreement, but says nothing about financing.

and conditions of the lease-leaseback documents that section 17406(a) governs, not the parties' actual performance under the contracts.

The terms of the lease-leaseback documents in this case fully comply with section 17406(a). The Facilities Lease required Harris to build the project on the site, and lease the site and the project back to FUSD. (1 AA 45.) It gave FUSD the right to use and enjoy the site and to take possession of the new facility as construction was completed during its term. (1 AA 47.)[14] And it provided FUSD would obtain title from Harris as construction progressed and corresponding lease payments were made, and upon full payment, title would be transferred to and vest in FUSD without further instrument of transfer. (1 AA 46-47.) The fact that FUSD may have chosen not to exercise its right to use and occupy the new facility until construction was complete does not make section 17406(a) inapplicable.

Moreover, the Court of Appeal's requirement of actual use, "as a tenant," during the term of the lease ignores the plain language of subdivision (a) that the lease-leaseback agreement may allow for title to vest in the school district *before* the term expires. The final sentence of section 17406(a) states that a lease-leaseback agreement "may provide for the means or methods by which title shall vest in the school district prior to

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[14] The Court of Appeal erroneously found that the Facilities Lease did not provide for FUSD to use the newly built facilities during the term of the lease. (Mod. Opn. 26, 27.)

the expiration of that term." The lease-leaseback agreement in this case, which allows – but does not require – FUSD to take title during the term, fits squarely within this provision. (1 AA 47.) And obviously, if title vests in a school district prior to expiration of the term, the district cannot thereafter use and occupy the property *as a tenant*, since it will then be the owner of the property.

The job of the courts is to apply statutes as written. The Court of Appeal's rewriting of section 17406(a) flies in the face of well-established rules of statutory construction and usurps the role of the Legislature. This Court should grant review to determine whether the Court of Appeal properly imposed new requirements not contained in the plain language of the statute.

D. The Court of Appeal's Opinion Ignores the Legislature's Express Directive to Liberally Construe the Provisions of the Education Code and the Broad Discretion Vested in School Districts

Even if the language of section 17406(a) was not clear and unambiguous, and it became necessary for the court to construe the statute, the Legislature has expressly directed in section 2 that the provisions of the Education Code, and all proceedings under it, are to be *liberally* construed.

The Court of Appeal committed clear error by strictly construing section 17406(a). (Mod. Opn. 8.)[15]

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[15] The Court of Appeal relied on *Unite Here Local 30 v. Department of Parks & Recreation* (2011) 194 Cal.App.4th 1200, 1209 as authority for [continued]

The opinion also ignores the broad discretion that is vested in school districts by the Constitution and the Legislature to conduct their affairs. (Cal Const. art. IX, § 14 [as amended Nov. 7, 1972, operative July 1, 1973]; section 35160, 35160.1.) Section 35160 provides that "the governing board of any school district may initiate and carry on any program, activity, or may otherwise act in any manner which is not in conflict with or inconsistent with, or preempted by, any law and which is not in conflict with the purposes for which school districts are established." In enacting section 35160, the Legislature expressly declared its intent "to give school districts ... broad authority," and that section 35160 shall "be liberally construed to effect this objective." (Section 35160.1.)

Indeed, Section 17406(a) itself confers broad discretion and flexibility on school districts specifically in connection with the use of lease-leaseback. The last sentence of subdivision (a) provides that "[t]he instrument ... shall contain such other terms and conditions as the governing board may deem to be in the best interest of the school district."

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strictly construing exceptions to competitive bidding. (Mod. Opn. 8.) However, that case and the case it cited as authority, *Marshall v. Pasadena Unified School District* (2004) 119 Cal.App.4th 1241, did not deal with section 17406 or any other provisions of the Education Code.

E. Guidance is Needed Regarding the Court of Appeal's New Requirements under Section 17406(a)

As discussed, the Court of Appeal held that in order to be a "genuine" or "true" lease under section 17406(a), the school district must actually use the newly built facilities, as a tenant, during the term of the lease. (Mod. Opn. 25, 26.) It construed "use" to mean "the occupation and utilization of the building in school operations." (Mod. Opn. 24.)

In addition to the other problems with this new requirement, detailed above, the opinion leaves open the important questions of *how long*[16] a district must actually use the premises as a tenant, as well as the *nature and extent* of the required "school operations," before a lease can be considered "genuine" or "true." Are "school operations" considered only classrooms, or would storage or administrative offices qualify? Is use and occupancy for one day enough? One week? One month? And must a school district use and occupy the entire project, or will use and occupancy of a building or two, or portions of one or more buildings, suffice? We know the *maximum* length of time a school district can be a tenant is 40 years (section 17403), but at what point between one day and 40 years, and for what purpose, must a district use and occupy the premises in order to satisfy the Court of Appeal's new requirement?

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[16] In fact, the court expressly declined to answer the question of how long a district must "use and occupy the project as a tenant before the 'true character' of the transaction is a lease and not a traditional construction contract." (Mod. Opn. 26, fn. 13.)

The same is true for the requirement that the lease-leaseback agreement must include a financing component. The court gave no insight whatsoever as to what methods, terms, or conditions of financing would be sufficient to satisfy this new requirement. Also, must the entire project be financed, or will it suffice if a school district finances only part of the total cost? And if the latter, what percentage of the total cost must be financed in order to meet this new requirement? If there is a payback plan for several years, will an option for the school district to pay it back sooner "negate" the financing component?

The questions the Court of Appeal left unanswered will negatively impact school districts' ability to participate in any kind of lease-leaseback agreements in the future. Very few, if any, contractors would be willing to enter into such agreements knowing they could be forced to return all monies paid to them if their agreement is later deemed to be illegal.

F. The Court of Appeal's Opinion Regarding Government Code Section 1090 is Contrary to the Legislature's Intent

Government Code section 1090, by its express terms, only applies to "[m]embers of the Legislature, state, county, district, judicial district, and city officers or employees." Section 1090 does not include consultants and independent contractors. The Court of Appeal defined the term "employee" to include corporate consultants hired by a local

government. (Mod. Opn. 38-40.) This is contrary to the intent of the Legislature.

After Government Code section 1090 was enacted, the Legislature enacted Public Contract Code section 10365.5 in 1990, which applies to contracts with state agencies. (Added Stats 1990 ch 344 § 1 [AB 3285].) Subdivision (a) of Public Contract Code section 10365.5 provides that "[n]o 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." There would have been no reason for the Legislature to enact Public Contract Code section 10365.5 if it had intended Government Code Section 1090 to apply to consultants.

The Legislative History of Public Contract Code section 10365.5 confirms the Legislature did not intend to include consultants in Government Code section 1090. (Ex. K to Motion for Judicial Notice.) Specifically, the Legislative Counsel opined in a letter to Assemblyman Steve Clute, the author of AB 3285, that *no provision of state law* prohibited a private firm which contracts with a state agency for consulting services in connection with the development of plans for the construction and operation of a veterans' home from thereafter contracting

with the agency for the construction and operation of the home. (Ex. K to Motion for Judicial Notice [January 25, 1990 letter from Legislative Counsel of California to Hon. Steve Clute].) Likewise, in requesting coauthors for his bill, Assemblyman Clute stated, "[w]hile current conflict of interest codes prevent state employees from bidding on contracts they wrote, *private consultants are not covered.*" (Ex. K to Motion for Judicial Notice [May 16, 1990 Request for Coauthors, AB 3285; italics added].) Similarly, Assemblyman Clute stated in his letter to the Governor, *"[e]xisting law does not address ... people who work for the state under consulting services contracts.* My measure would ... prohibit, with some exceptions, the recipient of a consulting services contract from bidding for or receiving contracts which are the end product of their consulting services work." (Ex. K to Motion for Judicial Notice [July 9, 1990 letter from Assemblyman Steve Clute to Hon. George Deukmejian; italics added].)

Even more to the point, an attempt was recently made during the 2013-2014 legislature session to amend section 1090 itself to include independent contractors. The Legislative Counsel's Digest for AB 1059[17] explains:

"Existing law prohibits Members of the Legislature, and state, county, district, judicial district, and city officers or employees from being financially interested in any contract made by them in their official capacity,

[17] AB 1059 died in the Assembly without going to a vote. (Exhibit J to Motion for Judicial Notice.)

or by any body or board of which they are members. Existing law further prohibits these public officers and employees from being purchasers at any sale, or vendors at any purchase, made by them in their official capacity. A violation of these provisions is a crime.

This bill would *extend application of those prohibitions to independent contractors* who perform a public function, and specifically provide when an independent contractor, or owner, officer, employee, or agent of the independent contractor, has a financial interest in a contract. By expanding the scope of a crime, the bill would impose a state-mandated local program." (Ex. J to Motion for Judicial Notice; italics added.)

Thus, the Legislature clearly understood and believed, before the Court of Appeal's contrary opinion in this case, that section 1090 *does not* extend to consultants and independent contractors.

G. The Court of Appeal's Opinion Regarding Government Code Section 1090 Violates Established Rules of Statutory Construction and is Inconsistent with Decisions from this Court and other Courts of Appeal

The Court of Appeal's opinion also violates fundamental principles of statutory construction and is inconsistent with decisions from this Court.

Specifically, as this Court stated in *Reynolds v. Bement* (2005) 36 Cal.4th 1075, "[a] statute will be construed in light of the common law unless the Legislature clearly and unequivocally indicates otherwise." (*Id.* at 1086-1087, internal quotes and citation omitted.) In particular, if "'a statute refer[s] to employees without defining the term [then] courts have generally applied the common law test of employment.'" (*Id.* at 1087, quoting *Metropolitan Water Dist. v. Superior Court* (2004) 32 Cal. 4th 491, 500 [discussing Gov. Code § 20028(b); see also *People v. Palma* (1995) 40

Cal.App.4th 1559, 1565-1566 ["as a general rule, when 'employee' is used in a statute without definition, the Legislature intended to adopt the common law definition and to exclude independent contractors"].) Under the common law test, independent contractors are not employees. (3 Witkin, Summary of Cal. Law (10th ed. 2005) Agency and Employment, § 21, pp. 60-61.)

The Court of Appeal's opinion also conflicts with the decision in *Klistoff v. Superior Court* (2007) 157 Cal.App.4th 469, in which the Second District Court of Appeal held that defendants, a waste hauling business and its principal, could not violate Government Code section 1090 because the principal was not a board member, officer or employee of the City, and "[t]he prohibition of section 1090 *does not reach beyond these public officials*." (*Id.* at 479-480, italics added.)

H. The Court of Appeal's Opinion Regarding Government Code Section 1090 Conflicts with Public Contract Code Section 10365.5, Subdivision (c)

In enacting Public Contract Code section 10365.5, discussed above, the Legislature created an express exception for consultants who provide planning and project management services. Subdivision (c) of section 10365.5 states: "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." Chapter 10 of Division 5 of

Title 1 of the Government Code pertains to contracts with private architects, engineering, land surveying, and construction management firms.

The Court of Appeal's broad expansion of the term "employee" in section 1090 to include corporate consultants would include consultants on state projects who provide planning and project management consultation services. As such, the holding conflicts with subdivision (c) of section 10365.5 of the Public Contract Code.

This court should grant review to determine whether the Court of Appeal properly defined the term "employee" in Government Code section 1090 to include corporate consultants.

VII. CONCLUSION

For the reasons discussed above, this Court should grant review on both issues.

Dated: July 12, 2015.

DOWLING AARON INCORPORATED

By: _____
Lynne Thaxter Brown
Attorneys for
Defendant/Appellant/Petitioner
FRESNO UNIFIED SCHOOL
DISTRICT

CERTIFICATE OF WORD COUNT

The text in this Petition for Review is proportionally spaced. The typeface is Times New Roman, 13 point. The word count generated by the Microsoft Word© word processing program used to prepare this Opening Brief, for the portions subject to the restrictions of California Rules of Court, Rule 8.204(c), is 6,635.

Dated: July 12, 2015. DOWLING AARON INCORPORATED

By _____
Lynne Thaxter Brown
Attorneys for Defendant/Respondent and Petitioner FRESNO UNIFIED SCHOOL DISTRICT

EXHIBIT A

Filed 6/19/15 (unmodified opinion attached)

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIFTH APPELLATE DISTRICT

STEPHEN K. DAVIS, Plaintiff and Appellant, v. FRESNO UNIFIED SCHOOL DISTRICT et al., Defendants and Respondents.	F068477 (Super. Ct. No. 12CECG03718) **ORDER MODIFYING OPINION** **[No Change in Judgment]**

THE COURT:

It is ordered that the published opinion filed herein on June 1, 2015, be modified as follows:

1. On page 3, the second sentence of the first paragraph under the facts heading, change "In September 2012" to "On September 26, 2012."

2. At the end of the last paragraph on page 4, the last two sentences beginning "However, consistent" and ending with "in fact, terminated," are deleted and the following sentences are inserted in their place.

> However, consistent with Davis's allegations of fact, Fresno Unified's opening brief acknowledged the Facilities Lease was in effect only during the construction of the school facilities and its counsel confirmed during oral argument that a phased completion of the project was not used in this case. Thus, the brief and counsel's statement do not contradict the allegation that Fresno Unified did not occupy or use the newly constructed facilities during the term of the Facilities Lease.

3. On page 5, the first paragraph under the proceedings heading, "In November 2012" is changed to "On November 20, 2012."

4. On page 5, the first sentence of footnote 4 beginning with "Defendants could have" is deleted and the following sentence is inserted in its place.

> Defendants could have avoided the uncertainty and risk associated with completing the project while this taxpayer challenge was pending by bringing a validation action under Code of Civil Procedure section 860 prior to starting construction.

5. On page 5, footnote 4, the following paragraph is added to the end of footnote 4.

> Davis's taxpayer suit is a timely "reverse validation" action because it was filed within 60 days of the adoption of the resolutions authorizing the execution of the Lease-Leaseback Contracts. (See Code Civ. Proc., §§ 860, 863.) Besides being a taxpayer, Davis is the president of Davis Moreno Construction, Inc., a general contractor that has handled construction projects for school districts. (See *Department of Industrial Relations v. Davis Moreno Construction, Inc.* (2011) 193 Cal.App.4th 560, 573; *Davis Moreno Construction, Inc. v. Frontier Steel Bldgs. Corp.* (E.D.Cal. Nov. 9, 2009, No. CV-F-08-854 OWW) 2009 U.S.Dist. Lexis 104167.)

6. On page 10, the second full paragraph, at the end of the second full sentence the word "lease" is changed to "leaseback." So the end of the sentence now reads: "namely, the term of the leaseback."

7. The last two sentences of the second paragraph on page 10 and continuing to page 11, beginning "However, the parties to a" and ending "lease-leaseback arrangement" are deleted and the following sentences and footnote are inserted in their place. This shall be footnote number 9, which will require renumbering of all subsequent footnotes.

> However, the parties to a lease-leaseback arrangement can achieve the same result without structuring the transaction as a lease-leaseback. For instance, the same extended stream of payments to the builder can be set forth in a payment schedule to a traditional construction agreement. Also, such an agreement can provide the school district with the same use and ownership of the new facilities that it received under a lease-leaseback arrangement. [9]

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[9] Here, Davis alleged that the terms governing the construction and payments could have been set forth in a "traditional purchase

type construction contract" and, as a result, the formalities of a site lease and leaseback added nothing *of substance* to the transaction because they did not provide financing for the project.

8. On page 11, the first sentence of the first full paragraph, beginning "Consequently, we" is deleted and the following sentence is inserted in its place.

> The fact that the same results could have been achieved under an alternate, simpler contractual arrangement leads us to consider why the Legislature chose a complicated lease-leaseback structure for builder-financed construction.

9. At the end of the third paragraph on page 17, after the sentence ending "or any other published decision," add as footnote 11 the following footnote, which will require renumbering of all subsequent footnotes.

> [11] The current use of section 17406 as a lease-leaseback delivery method has not been without controversy, which may explain why the Construction Provisions contain an indemnity provision whereby Fresno Unified agreed to "indemnify, hold harmless and defend Contractor…from any action…to challenge the propriety or legal authority of [Fresno Unified under section 17406] to enter into the Construction Provisions, the Site Lease or the Facilities Lease." Fresno Unified also agreed to pay all Contractor's costs in defending any such action, including any legal fees and judgments.

10. On page 23, the following sentence is added to the end of the second full paragraph.

> They also support Davis's allegations that the true nature of the Lease-Leaseback Contracts was that of a "traditional purchase type construction contract" and the purpose for using the lease-leaseback arrangement was to avoid the competitive bidding process by subterfuge or sham.

11. At the end of the second full paragraph on page 33, after the sentence ending in "project is being constructed," add as footnote 18 the following footnote, which will require renumbering of all subsequent footnotes.

> [18] For purposes of demurrer, we accept the allegations about the existence and contents of the prior contract as true, even though counsel for Fresno Unified stated during oral argument that there was no preconstruction contract.

12. On page 33, third full paragraph, in the first sentence the word "referred" is changed to "refers" and in the second sentence the word "cited" is changed to "cites."

13. On page 41, first sentence of the second full paragraph, the word "fact" is changed to "facts."

There is no change in judgment.

Franson, J.

WE CONCUR:

Levy, Acting P.J.

Gomes, J.

Filed 6/1/15 (unmodified version)

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIFTH APPELLATE DISTRICT

STEPHEN K. DAVIS, Plaintiff and Appellant, v. FRESNO UNIFIED SCHOOL DISTRICT et al., Defendants and Respondents.	F068477 (Super. Ct. No. 12CECG03718) **OPINION**

APPEAL from judgment of the Superior Court of Fresno County. Donald S. Black, Judge.

Carlin Law Group and Kevin R. Carlin for Plaintiff and Appellant.

Briggs Law Corporation, Cory J. Briggs, Mekaela M. Gladden and Anthony N. Kim for Kern County Taxpayers Association as Amicus Curiae on behalf of Plaintiff and Appellant.

Atkinson, Andelson, Loya, Ruud & Romo, Martin A. Hom and Jennifer D. Cantrell for Defendant and Respondent Fresno Unified School District.

Fagen Friedman & Fulfrost, Kathy McKee, Paul G. Thompson, James Traber and Luke Boughen for California's Coalition for Adequate School Housing as Amicus Curiae on behalf of Defendant and Respondent Fresno Unified School District.

Lozoya & Lozoya and Frank J. Lozoya for Defendant and Respondent Harris Construction Company, Inc.

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Plaintiff Stephen Davis is a taxpayer challenging a noncompetitive bid contract between the Fresno Unified School District (Fresno Unified) and Harris Construction Co., Inc. (Contractor) for the construction of a middle school for $36.7 million. The construction was completed in 2014 pursuant to a lease-leaseback arrangement that Fresno Unified and Contractor contend is exempt from competitive bidding under Education Code section 17406.[1]

Davis alleged the school construction project should have been competitively bid because the lease-leaseback arrangement did not create a true leaseback or satisfy the criteria for the exception in section 17406. Davis also alleged Fresno Unified's board breached its fiduciary duties by approving the costly arrangement and Contractor had an impermissible conflict of interest that rendered the lease-leaseback agreement void.

The trial court sustained demurrers filed by Fresno Unified and Contractor. Davis appealed.

As to the causes of action based on the Education Code, we conclude (1) the competitive bidding process required by section 17417 is subject to the exception contained in section 17406 and (2) Davis adequately alleged three grounds for why section 17406's exception did not apply to the lease-leaseback arrangement. First, Davis alleged the exception is available only for genuine leases and the subject leaseback agreement was simply a traditional construction agreement and not a genuine lease. Second, Davis alleged the agreement did not include a financing component for the construction of the project. Third, Davis alleged the lease-leaseback arrangement did not

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1 All further statutory references are to the Education Code unless otherwise stated.

provide for Fresno Unified's use of the newly built facilities "during the term of the lease," as required by section 17406.

As to the conflict of interest cause of action, we conclude Government Code section 1090's prohibition of such conflicts extends to corporate consultants. Davis has stated a violation of Government Code section 1090 by alleging facts showing Contractor, as a consultant to Fresno Unified, participated in the making of a contract in which Contractor subsequently became financially interested.

We therefore reverse the judgment.

FACTS

This case involves a project for the construction of buildings and facilities at the Rutherford B. Gaston Sr. Middle School, located in southwest Fresno. In September 2012, Fresno Unified's governing board adopted a resolution authorizing the execution of contracts pursuant to which Fresno Unified would lease the project site to the Contractor, which would build the project on the site, and lease the improvements and site back to Fresno Unified. The contracts were a Site Lease and a Facilities Lease (collectively, the Lease-Leaseback Contracts).

Under the Site Lease, Fresno Unified leased the project site to Contractor for $1 in rent. The Site Lease began on September 27, 2012, and terminated the same day as the Facilities Lease. The Site Lease is the "lease" in the lease-leaseback arrangement.

The Facilities Lease was structured so that Contractor would (1) build the project on the site pursuant to the "Construction Provisions" attached as an exhibit to the Facilities Lease and (2) sublease the site and project to Fresno Unified[2] in exchange for payments under a "Schedule of Lease Payments." The Construction Provisions were a detailed construction agreement (55 pages long) whereby Contractor agreed to build the

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[2] This sublease by Contractor of the site and facilities to Fresno Unified constitutes the "leaseback" part of the lease-leaseback arrangement.

project in accordance with the plans and specifications approved by Fresno Unified for a guaranteed maximum price of $36,702,876. Completion was to be 595 days from the notice to proceed.

The "Schedule of Lease Payments" attached to the Facilities Lease simply referred to the "payments for the Project as set forth in the Construction Provisions." The Construction Provisions outlined monthly progress payments for construction services rendered each month, up to 95 percent of the total value for the work performed, with a 5 percent retention pending acceptance of the project and recordation of a notice of completion. Final payment for all of the work was to be made within 35 days after recordation by Fresno Unified of the notice of completion. Simply put, the funds paid by Fresno Unified under the Facilities Lease were based solely on the construction services performed by Contractor.[3]

Once the project was completed and the final lease payment made, the Facilities Lease terminated. Counsel for Fresno Unified confirmed at oral argument that the term of the lease was from the date of signing to the date of completion. As to possession of the project, the Facilities Lease stated that Fresno Unified was allowed to take possession of the project "as it is completed." However, consistent with Davis's allegations of fact, Fresno Unified's opening brief acknowledged the Facilities Lease was in effect only during the construction of the school facilities. This fact was confirmed during oral argument when counsel for Fresno Unified stated that Fresno Unified did not occupy the school facility until the lease was, in fact, terminated.

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[3] Thus, the progress payments made by Fresno Unified under the Facilities Lease were not "rent" in the usual sense of the word—that is, consideration paid periodically in exchange for the use or occupancy of real property. (Black's Law Dictionary (9th ed. 2009) p. 1410 [definition of rent].)

As to ownership of the newly constructed improvements, the Facilities Lease provided that Fresno Unified would obtain title from Contractor "as construction progresses and corresponding Lease Payments are made to [Contractor]." In addition, the Facilities Lease provided that once Fresno Unified paid all of the lease payments, all rights, title and interest of Contractor in the project and the site would vest in Fresno Unified.

PROCEEDINGS

In November 2012, Davis filed his original complaint.[4] The operative pleading is the first amended complaint (FAC) he filed in March 2013. The causes of action in the FAC are (1) violation of the competitive bidding requirements of the Public Contract Code by entering into an improper lease-leaseback arrangement that did not satisfy the criteria for the statutory exception outlined in subdivision (a)(1) of section 17406 (section 17406(a)(1)); (2) breach of fiduciary duty by the Board of Fresno Unified; (3) failure to comply with the competitive bidding requirements of section 17417; (4) conflict of interest by Contractor based on its participation in the planning and design of the project as a consultant to Fresno Unified before the contracts for the project's construction were awarded; (5) improper use of section 17400 et seq., based on the legal theory that lease-leaseback arrangements are allowed only when used for financing school construction; (6) improper delegation of discretion; and (7) declaratory relief.

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[4] Defendants could have avoided this post-completion taxpayer challenge by bringing a validation action under Code of Civil Procedure section 860 prior to construction of the project. "A validation action ... allows a public agency to obtain a judgment that its financing commitments are valid, legal, and binding. If the public agency has complied with statutory requirements, the judgment in the validation action binds the agency and all other persons." (*Friedland v. City of Long Beach* (1998) 62 Cal. App.4th 835, 838.) The record in this case shows that the use of validation actions is a common practice for school construction projects structured as a lease-leaseback arrangement. (See fn. 5, *post.*)

Davis alleged that, although the site was leased by Fresno Unified to Contractor while Contractor performed the construction, there was no genuine leaseback to Fresno Unified because Fresno Unified did not regain the right to use and occupy the property during the leaseback period. Davis also alleged that Fresno Unified made payments that lasted only as long as the duration of construction, varied based upon the value of the work performed, and ended with the completion of the construction. In addition, Davis alleged that Fresno Unified did "not have the right or practical ability to have beneficial occupancy of the demised premises during the term of the Facilities Lease to use them for their intended purposes."

In April 2013, Fresno Unified filed a demurrer to the FAC, which was supported by a request for judicial notice.[5] In May 2013, Contractor filed a separate demurrer that was similar to Fresno Unified's.

Davis opposed the demurrers and objected to the request for judicial notice. Davis also lodged 11 exhibits with the trial court to support his opposition to the demurrers.

In August 2013, the trial court sustained both demurrers to each of the seven causes of action in the FAC. The court granted Davis 30 days leave to amend. Counsel for Davis informed counsel for Fresno Unified that Davis did not intend to file a second amended complaint. After the 30-day period expired, defendants filed applications for dismissal of the action and entry of judgment.

In September 2013, judgment was entered in favor of Fresno Unified and Contractor. Davis appealed.

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5 Fresno Unified's request for judicial notice included copies of 22 default judgments entered from December 2010 to July 2012 in validation actions brought by school districts in Los Angeles, Orange, Riverside, San Bernardino, Ventura and Kern Counties. The default judgments stated that site leases, subleases, and construction services agreements entered into by the school districts pursuant to section 17406 were not subject to the requirement in Public Contract Code section 20111 that construction contracts be awarded to the lowest responsible bidder.

DISCUSSION

I. STANDARD OF REVIEW

A. Demurrers

Appellate courts independently review the ruling on a general demurrer and make a de novo determination of whether the pleading alleges facts sufficient to state a cause of action. (*McCall v. PacifiCare of Cal., Inc.* (2001) 25 Cal.4th 412, 415.)

Generally, appellate courts "give the complaint a reasonable interpretation, reading it as a whole and its parts in their context. [Citation.]" (*City of Dinuba v. County of Tulare* (2007) 41 Cal.4th 859, 865 (*Dinuba*).) Also, the demurrer is treated as admitting all material facts properly pleaded, but does not admit the truth of contentions, deductions or conclusions of law. (*Ibid.*)

Ordinarily, the allegations in a pleading "must be liberally construed, with a view to substantial justice between the parties." (Code Civ. Proc., § 452.) However, this principle of liberal construction does not apply when, as in this case, a plaintiff has been granted leave to amend and elects not to do so. (*Reynolds v. Bement* (2005) 36 Cal.4th 1075, 1091, abrogated on another ground in *Martinez v. Combs* (2010) 49 Cal.4th 35, 62-66.) In such cases, appellate courts will construe the pleading strictly, based on the rationale that the plaintiff's election indicates he or she believes the pleading has stated the strongest case possible. (*Reynolds, supra,* at p. 1091.)

B. Statutory Construction

This appeal presents a number of issues relating to the proper construction of the Education Code provisions addressing lease-leaseback arrangements and the Government Code provisions addressing conflicts of interest.

Issues of statutory construction are questions of law subject to independent review by appellate courts. (*Neilson v. City of California City* (2007) 146 Cal.App.4th 633, 642.)

"A reviewing court's fundamental task in construing a statute is to determine the intent of the lawmakers so as to effectuate the purpose of the statute. [Citations.] Courts start this task by scrutinizing the actual words of the statute, giving them their usual, ordinary meaning. [Citation.] When statutory language is clear and unambiguous (i.e., susceptible to only one reasonable construction), courts adopt the literal meaning of that language, unless that literal construction would frustrate the purpose of the statute or produce absurd consequences. [Citation.]

"Alternatively, when the statutory language is ambiguous, courts must select the construction that comports most closely with the apparent intent of the Legislature, with a view to promoting rather than defeating the general purpose of the statute. [Citation.] The interpretation of ambiguous wording is guided by the fundamental principle that courts construe those words in the context and with reference to the entire scheme of law of which they are a part. [Citations.] Courts resolving statutory ambiguity also may be aided by the ostensible objects to be achieved by the legislation, the evils to be remedied, the legislative history, and public policy. [Citation.] When a court interprets an ambiguous statute, it is not authorized to rewrite the statute. It must simply declare what is, in terms or in substance, contained in the statute. [Citation.]" (*POET, LLC v. State Air Resources Bd.* (2013) 218 Cal.App.4th 681, 749.)

The foregoing rules of statutory construction are subject to specific rules that apply to particular types of statutes. The specific rule relevant in this case provides that any statutory exception to competitive bidding requirements for government contracts are to be *strictly* construed. (*Unite Here Local 30 v. Department of Parks & Recreation* (2011) 194 Cal.App.4th 1200, 1209; see 45A Cal.Jur.3d (2008) Municipalities, § 524, p. 301 [exception to competitive bidding should be strictly construed and restricted to circumstances that truly satisfy the statutory criteria].)

II. EXCEPTION TO COMPETITIVE BIDDING—FIRST CAUSE OF ACTION

A. Background

School districts can procure new facilities in various ways based on (1) different methods for financing the project and (2) different delivery methods for the construction.

1. Traditional Financing and Delivery

The traditional method for financing new school facilities is for school districts to obtain voter approval for the issuance of general obligations bonds and then use the proceeds from the bonds to pay for the construction. (62 Ops.Cal.Atty.Gen. 209, 210 (1979).)

The traditional delivery method for new school facilities is referred to as design-bid-build, which involves three separate steps. (See 10 Miller & Starr, Cal. Real Estate (3d. ed. 2010) § 27:27, p. 27-143.) First, the school district hires an architect to design the project. Second, the district uses the design in its request for competitive bids from construction firms. Third, the winning bidder builds the project.

School construction contracts are a type of public works contract subject to the competitive bidding process unless an exception applies. (See Pub. Contract Code, § 20111, subd. (b).) Competitive bidding is favored by a strong public policy "'"to eliminate favoritism, fraud and corruption; avoid misuse of public funds; and stimulate advantageous marketplace competition."' [Citation.]" (*Marshall v. Pasadena Unified School Dist.* (2004) 119 Cal.App.4th 1241, 1256-1257.)

2. Lease-Leaseback Delivery and Financing Method -- Section 17406

In 1957, the Legislature authorized another method for financing and delivery of new school facilities and made it exempt from the competitive bidding process. (Stats. 1957, ch. 2071, § 1, pp. 3682-3687.) This method, the crux of this appeal, has been referred to as a lease-purchase, but is now referred to as a "lease-leaseback" arrangement.[6] (See 56 Ops.Cal.Atty.Gen. 571, 572 (1973); *Los Alamitos Unified School Dist. v. Howard Contracting, Inc.* (2014) 229 Cal.App.4th 1222, 1224 (*Los Alamitos*).)

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[6] A good description of the use of a lease-leaseback arrangement for a public construction project is set forth in *City of Desert Hot Springs v. County of Riverside* (1979) 91 Cal.App.3d 441, 447-449.) There, the city leased land to a contractor for 50 years and the contractor subleased the completed city hall and public library back to the city for 15 years, with options for the city to purchase the buildings after five and 10

Under the lease-leaseback method, the school district leases land that it owns to a construction firm for a nominal amount ($1.00) and the construction firms agrees to build school facilities on that site. (§ 17406(a)(1).)[7] The construction firm builds the facilities and leases them back to the school district for a specified time at a specified rental amount. Thus, the "leaseback" part of the arrangement involves the construction firm acting as landlord of the newly constructed facilities and the school district acting as the tenant. At the end of the lease, title to the new facilities must vest in the school district. (§ 17406(a)(1).)[8]

Under this financing method, the builder finances the project (probably with assistance from a third party lender) and is paid over the term of the lease, which can last 40 years. (§ 17403; Stats. 1957, ch. 2071, p. 3683 [former § 18353].) The economic reality of the lease-leaseback arrangement is that the builder carries both the cost of construction and financing while the school district compensates the builder with a stream of payments spread over a specified period—namely, the term of the lease. However, the parties to a lease-leaseback arrangement could achieve the same economic effect (i.e., stream of payments) and end result (i.e., the construction of facilities eventually owned by the district) without using a lease-leaseback arrangement. The same terms governing the construction and payment could be adopted in a traditional

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years. (*Id.* at pp. 444-445.) The case also illustrates the contractor's use of the site lease and leaseback as security for a construction loan with a pay-off period equal to the term of the leaseback. (*Id.* at p. 445.)

[7] Since its adoption in 1957, this section has been numbered 18355 (1957-1959), 15705 (1959-1976), 39305 (1976-1996), and 17406 (1996 to present). (Stats. 1957, ch. 2071, § 1, p. 3683; Stats. 1959, ch. 2, § 1, pp. 1086-1087; Stats. 1976, ch. 1010, § 2, p. 3167; Stats. 1996, ch. 277, § 3 p. 2126.)

[8] This type of lease-leaseback arrangement should not be confused with the type of arrangement authorized by the Leroy F. Greene State School Building Lease-Purchase Law of 1976, which involves state funding of construction. (§§ 17000-17066.)

construction contract, without a lease of the site and a leaseback of the facility, that included a long-term payment plan requiring the exact same payments as would have been contained in the lease-leaseback arrangement.

Consequently, we consider why the Legislature chose a complicated lease-leaseback structure for builder-financed construction. The answer appears to be related to (1) a constitutional provision that prohibited counties, cities and school districts from incurring any indebtedness or liability exceeding the amount of one year's income without the assent of two-thirds of its voters and (2) the California Supreme Court's determination that leases do not create an indebtedness for the aggregate amount of all installments, but create a debt limited in amount to the installments due each year. (See *City of Los Angeles v. Offner* (1942) 19 Cal.2d 483 [applying former Cal. Const. art. XI, § 18] (*Offner*).) Thus, the Legislature adopted the lease-leaseback structure to create a way for school districts to pay for construction over time and avoid the constitutional limitation on debt. (See former § 18364 [amount of rental a district agrees to pay during any one year is an obligation of such district for such year only]; Stats. 1957, ch. 2071, §1, p. 3686.)

Therefore, the formalities of the lease-leaseback arrangement were important to the Legislature in 1957 because of their effect on the project's financing. Specifically, the formalities spread the school district's liability for the construction and carrying costs over the term of the leaseback and limited the amount of debt attributed to the district for any one year.

Next, we consider each component of a traditional lease-leaseback arrangement and the function of that component. The "lease" part of the lease-leaseback arrangement—that is, the agreement pursuant to which the school district leases real estate it owns to a construction firm for $1.00 for the purpose of building new facilities on that real estate—serves three functions. First, the site lease gives the contractor a possessory or leasehold interest in the real estate so that the contractor holds sufficient

property rights or interests to serve as the foundation for the leaseback. The fact the contractor holds these rights to the land lends weight and legitimacy to the leaseback and helps avoid the constitutional limitation on debt exceeding one year's income. (See *Offner*, *supra*, 19 Cal.2d at p. 486 [the aggregate amount of payments under a subterfuge lease are a present liability for purposes of the constitutional limitation on debt].) Second, the site lease solidifies the bundle of property and contractual rights (particularly the rental payments under the leaseback) that the construction firm can use as collateral to obtain third party financing. (See fn. 6, *ante*.) Third, the site lease formalizes the contractor's right to enter and occupy the location while building the new facilities. This last function is insignificant compared to the other two because California law implies into every construction contract a covenant that the owner will provide the contractor timely access to the project site. (*Howard Contracting, Inc. v. G. A. MacDonald Construction Co.* (1998) 71 Cal.App.4th 38, 50.)

The "leaseback" part of a lease-leaseback arrangement is the mechanism by which (1) the contractor is compensated for its construction services and the cost of financing the project and (2) the school district's obligation to pay for the project is spread over a period of time. The leaseback, with its payment term of up to 40 years, allows a school to acquire facilities that it might not be able to pay for using other financing methods. As a result, the lease-leaseback method opened up a new source of financing for school construction—namely, private sector funding through the contractor and a third party lending money to the contractor. Given the difficulties in obtaining adequate funding for the school construction needs of California in the post-war era, it appears that the primary purpose for the Legislature's adoption of section 17406(a)(1)'s predecessor in 1957 was to provide a new source of financing for school construction. Use of the new source was encouraged by providing an exception to competitive bidding. The exception would have allowed school districts, contractors and lenders to enter into earnest negotiations of the construction and financing arrangements without the concern that the deal would be

subsequently derailed by the competitive bidding process. The exception also prevented school districts from being required to balance apples (construction terms) against oranges (financing terms) to determine which proposal was the lowest bid.

Based on the statutory language and historical context, we conclude the primary purpose for the adoption of section 17406(a)(1)'s predecessor was to provide a new source of financing for the construction of schools. We have not located, and the parties have not cited, any sources indicating the formalities inherent in traditional lease-leaseback arrangements had any importance to the design or construction aspects of the project. Thus, to the extent that defendants or an amicus curiae suggest the Legislature intended to create a broad or easily satisfied exception to the competitive bidding process because competitive bidding resulted in slower, more costly construction,[9] we regard this

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[9] These criticisms of competitive bidding are reflected in the findings made by the Legislature in connection with its adoption of the design-build delivery method of school construction. In 2001, the Legislature added a chapter to the Education Code authorizing the use of "design-build" contracts for school construction. (Stats. 2001, ch. 421, § 1 (Assem. Bill No. 1402); §§ 17250.10-17250.50.) Under the design-build delivery method, both the design and construction work is let to a single entity, which centralizes responsibility for both aspects of the project. (§ 17250.15, subd. (b) [definition of design-build]; see 10 Miller & Starr, Cal. Real Estate, *supra*, § 27:27, p. 27-143.) Design-build contracts are not subject to the competitive bidding requirements in Public Contract Code section 20110, but the school district must (1) invite competitive sealed proposals, (2) award the contract to the responsible bidder whose proposal is determined to provide the "best value" to the school district, and (3) comply with the other requirements in section 17250.25. This selection method has been described as competitive selection.

The Legislature found the benefits of the design-build delivery method "include accelerated completion of the projects, cost containment, reduction of construction complexity, and reduced exposure to risk for the school district." (§ 17250.10, subd. (b).) Also, school districts may benefit "by shifting the liability and risk for cost containment and project completion to the design-build entity." (*Ibid.*) The Legislature also declared its intent "that design-build procurement does not replace or eliminate competitive bidding." (§ 17250.10, subd. (f).)

The design-build delivery method was not utilized for the current project and, therefore, has no direct application to this case.

view of Legislative intent as unsupported by legislative history, historical context, or the concerns being addressed in 1957.

In the future, a Legislature might balance the various costs and benefits associated with competitive bidding and with lease-leaseback arrangements and find there are efficiencies that justify excepting lease-leaseback arrangements from competitive bidding even when those arrangements do not provide financing for the construction. While the Legislature is free to make such a finding and amend the statute, we cannot treat recent criticism of competitive bidding as providing insight into the intent of the Legislature in 1957.

Our view that obtaining a new source of school financing was the primary purpose of the lease-leaseback provisions in sections 17400 through 17425 is supported by *Morgan Hill Unified School Dist. v. Amoroso* (1988) 204 Cal.App.3d 1083, which described former sections 39300 through 39325 (the predecessors of §§ 17400-17429) as authorizing a "method for financing school construction." (*Morgan Hill, supra,* at p. 1086.) Similarly, the Attorney General referred to former sections 39300 through 39305 as a construction funding method. (62 Ops.Cal.Atty.Gen., *supra,* at p. 210.)

Although the lease-leaseback delivery method was authorized in 1957, an alternate form has been growing in use throughout California over the past 15 years. This variation of the lease-leaseback arrangement is the type used by Fresno Unified and Contractor in this case. Under this alternate approach, the school district pays for the construction (using local bond funds) as it progresses, with the final payment being made when construction is completed. As a result, the school district does not occupy and use the new facilities as a rent-paying tenant for a set length of time. Because the school district pays for the construction as it is completed, this alternate approach cannot be characterized as a method of financing the construction of new school facilities.

B. Text of Section 17406

Section 17406 gives school boards the authority to lease school property to another under an instrument providing for the construction of buildings on the property. Specifically, section 17406 provides:

> "(a)(1) *Notwithstanding Section 17417*, the governing board of a school district, *without advertising for bids*, may let, for a minimum rental of one dollar ($1) a year, to any person, firm, or corporation any real property that belongs to the 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 prior to the expiration of that term, and shall contain other terms and conditions as the governing board may deem to be in the best interest of the school district." (Italics added.)

C. The Exception Includes Facilities Leases

An initial question of statutory construction raised by the parties is whether section 17406 creates an exception to competitive bidding for *both* the lease and the leaseback. Davis contends the exception applies only to the Site Lease and, therefore, the Facilities Lease (i.e., the leaseback) is subject to competitive bidding.

This specific question of statutory construction was addressed by the court in *Los Alamitos*, *supra*, 229 Cal.App.4th 1222. The court interpreted section 17406(a)(1)'s exception to competitive bidding as applying to the entire lease-leaseback arrangements, not just the site lease. (*Los Alamitos, supra,* at pp. 1224, 1229.) The text relied upon for this interpretation included the phrases "'without advertising for bids'" and "'[n]otwithstanding section 17417 ....'" (*Id.* at p. 1227.) The reference to section 17417 is significant because that section provides that leases entered into by school districts are subject to competitive bidding. The exception to competitive bidding was extended to facilities leases based on the language referring to an instrument that requires the contractor "to construct on the demised premises ... a building or buildings for the use of

the school district ...." (§ 17406(a)(1).) In *Los Alamitos*, the facilities lease provided for the construction of new facilities and the leasing of those facilities to the school district. As a result, the court concluded the facilities lease came within the statute's exception to competitive bidding. (*Los Alamitos, supra,* at pp. 1224, 1229.)

We agree with the statutory interpretation that the exception to competitive bidding in section 17406(a)(1) is not limited to site leases. (*Los Alamitos*, *supra*, 229 Cal.App.4th at pp. 1224, 1229.)

First, the ordinary meaning of the word "notwithstanding" is "in spite of." (Webster's 3d New Internat. Dict. (1993) p. 1545, col. 3.) It is well established that the phrase "notwithstanding any other provision of law" is a term of art that expresses a legislative intent to have the specific statute control despite the existence of other law that might govern. (*People v. Harbison* (2014) 230 Cal.App.4th 975, 985.) Therefore, we conclude the phrase "[n]otwithstanding Section 17417" means the bidding procedures set forth in section 17417 do not apply to agreements covered by section 17406(a)(1). The phrase "without advertising for bids" provides a further indication that competitive bidding is not required for agreements falling with section 17406(a)(1).

Second, the exception created by section 17406(a)(1) can reach both site leases and facilities leases, provided they meet the statutory criteria. The reference to an instrument that requires the lessee under a site lease "to construct on the demised premises ... a building or buildings for the use of the school district" clearly encompasses the construction services provided by a contractor to a school district under a facilities lease. (§ 17406(a)(1).) Therefore, a facilities lease that specifies the terms of construction is eligible for the exception.

The interpretation that the exception can apply to the entire lease-leaseback arrangement is confirmed by the Attorney General's statutory construction of the predecessor of section 17406, former section 15705. (56 Ops.Cal.Atty.Gen., *supra,* at pp. 579-581; see Stats. 1959, ch. 2, § 1, pp. 1086-1087.) Under the heading "*Leasing a*

completed school building," the Attorney General discussed the statutory scheme and opined:

> "It is concluded that the Legislature excluded an arrangement entered into under section 15705 from the notice and bid requirements. Because a school district is not required to obtain bids for lease arrangements under section 15705, it may lease its property for purpose of permitting the construction thereon of school buildings which the district will lease at such rental rates as the governing board deems in the best interests of the district without reference to competitive bidding." (56 Ops.Cal.Atty.Gen., *supra*, at p. 581.)

Based on the foregoing, we reject Davis's argument that the exception to competitive bidding in section 17406(a)(1) includes only site leases and excludes all leases under which a school district obtains newly built facilities from a construction firm, such as the Facilities Lease in this case.

The foregoing statutory interpretation does not resolve all the questions presented in this case about the meaning and application of section 17406(a)(1). The parties' arguments raise questions about whether the Facilities Lease satisfied the criteria set forth in section 17406(a)(1) and, as a result, qualified for the exception to the competitive bidding process. These arguments present issues regarding the proper interpretation of section 17406(a)(1) and how to apply that interpretation to the facts alleged in the FAC. These additional issues of statutory construction, and the related issues of the sufficiency of the taxpayer's allegations, were not addressed in *Los Alamitos*, *supra*, 229 Cal.App.4th 1222 or any other published decision.

D. Satisfaction of the Exception's Criteria

Davis's first cause of action includes the legal theory that the exception to competitive bidding in section 17406 only applies to genuine or true leases. This legal theory presents an issue of statutory construction. Specifically, does section 17406(a)(1) require the leases in a lease-leaseback arrangement to be genuine to qualify for the exception? If this statutory construction is adopted, we also must address whether

Davis's factual allegations are sufficient to support his claim that the Facilities Lease was not a genuine lease.

1. Statute Requires a Genuine Lease and Financing

Our interpretation of the statute begins with its words. Generally, the Legislature uses words to indicate substance, not merely as labels. For example, in *Williams v. Superior Court* (1993) 5 Cal.4th 337, the court refused to interpret a statute protecting law enforcement "investigatory" files from disclosure to mean that any file labeled "investigatory," regardless of its nature, was shielded from disclosure. (*Id.* at p. 355.) Based on the principle that words indicate substance, we conclude the word "lease" used in section 17406(a)(1)'s phrase "buildings for the use of the school district during the term of the lease" means something more than a document designated by the parties as a lease. Rather, the Legislature chose the term to indicate the substance of the transactions that are eligible for the exception.

This interpretation is consistent with the way courts treated the concept of a lease when section 17406(a)(1)'s predecessor was enacted in 1957. (See Stats. 1957, ch. 2071, § 1, p. 3683 [former § 18355].) For instance, in *Parke etc. Co. v. White River L. Co.* (1894) 101 Cal. 37, the Supreme Court considered a document that purported on its face to be a "lease." (*Id.* at pp. 38-39.) The court stated: "This paper is not a lease. Calling it a lease did not establish the fact. This is peculiarly a case where there is nothing in a name, for the contents of the paper determine its true character." (*Id.* at p. 39.) The court indicated that the true legal effect and intentions of the parties to an agreement is gathered from all of the language used in the instrument, not just the name given the document or the language in a particular provision. (*Id.* at pp. 39-40; see *San Francisco v. Boyle* (1925) 195 Cal. 426, 433-438; see also *Heryford v. Davis* (1880) 102 U.S. 235, 244 [form of an instrument is of little account; the legal effect of the whole is analyzed].)

Moreover, this well-established disregard for labels in favor of an examination of the substance of a document was applied by the California Supreme Court to a public

works contract 15 years before the Legislature enacted section 17406(a)(1)'s predecessor. In *Offner*, *supra*, 19 Cal.2d 483, the court considered whether a proposed agreement for the construction and leasing to the city of a rubbish incinerator was unconstitutional because it would create a debt in the year of its execution that exceeded the revenue then available to the city. (*Id.* at p. 484.) The court recognized that the proposed agreement, though designated as a "lease," might be a subterfuge. (*Id.* at p. 486.) Consequently, the court analyzed the agreement's terms and the intention of the parties before it concluded the proposed agreement constituted "in reality a lease with reasonable terms and option to purchase" that did not violate the yearly debt restriction in the California Constitution. (*Id.* at pp. 486-487.)

The case law that existed prior to 1957 also leads us to conclude that the Legislature used the word "lease" to indicate the substance required, not simply as a label. (See Civ. Code, § 3528 [the substance-over-form principle].) In addition, our view that the statutory exception is available only for genuine leases is supported by the principle that exceptions to competitive bidding requirements "should be strictly construed and restricted to circumstances which truly satisfy the statutory criteria." (*Marshall v. Pasadena Unified School Dist.*, *supra*, 119 Cal.App.4th at p. 1256.) Thus, to "truly satisfy the statutory criteria" in section 17406(a)(1) requires a true lease, not simply a traditional construction contract designated as a lease by the parties.

This interpretation of section 17406(a)(1) is not contradicted by legislative history. Defendants have provided, and we have located, no legislative history stating or implying that the criteria for the exception to competitive bidding is satisfied by any document the parties have labeled a lease.[10]

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[10] 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. (See Evid. Code, § 459.)

In summary, our review of the entire legislative scheme, the ostensible objects it seeks to achieve, the evils to be remedied, and the underlying public policies lead us to conclude the word "lease" refers to the substance of the transaction and means more than a document designated a lease by the parties. Moreover, to fulfill the primary statutory purpose of providing financing for school construction, the arrangement must include a financing component. (See pt. II.A.2, *ante*.)

2. Relevant Factors

The conclusion that the leaseback must be a true "lease" to satisfy the criteria in section 17406(a)(1) leads to the question of what factors are relevant to determining the true nature of an arrangement and whether it is a "lease" providing financing for purposes of section 17406(a)(1).

We conclude the true legal effect of the leaseback in question is based on the all the terms of the document. (See *Parke etc. Co. v. White River L. Co.*, *supra*, 101 Cal. at p. 39.) Provisions in the document that are significant include those that define (1) who holds what property rights and when those rights and interests are transferred between the parties and (2) the amount and timing of the payments. (See *Offner*, *supra*, 19 Cal.2d at p. 486.) The payment provisions, particularly the length of the period over which payments are made, are important in this context because the primary purpose of the legislation was to provide a source of financing for school construction and the payment provisions will show whether the project is being financed through the contractor or whether the school district is paying for the project by using funds from other source.

3. Sufficiency of the Allegations of a Subterfuge Lease

Paragraph 24 of the FAC alleges that the Lease-Leaseback Contracts "are merely a sham and subterfuge to avoid the requirements" in the Public Contract Code for competitive bidding. It also alleges the payments required by the Facilities Lease were are not real lease payments because they "(1) last only as long as the duration of the construction; (2) are variable based upon the value of construction work performed by

CONTRACTOR prior to the date of payment; (3) do not provide for any financing of the work by CONTRACTOR (because its obligation to pay others who are actually providing the labor, equipment, materials and services for the construction of the Project is contingent upon it first receiving payment for the same from the DISTRICT); (4) the lease payments end concurrently with the completion of construction of the Project by CONTRACTOR; (5) the Project is being performed and administered in a manner consistent with [the statute governing competitive bidding] rather than with Education Code §§ 17400-17429; (6) the DISTRICT is withholding retention of its payments to CONTRACTOR and requiring CONTRACTOR to provide payment and performance bonds; (7) the DISTRICT does not have the right or practical ability to have beneficial occupancy of the demised premises during the term of the Facilities Lease to use them for their intended purposes."

These allegations are supported by the contents of the Site Lease and the Facilities Lease and their attachments, such as the Construction Provisions, which were included in the FAC as exhibits and incorporated by reference. Therefore, the terms of the Site Lease and the Facilities Lease are before this court, which assists our analysis of the true character of the transaction. (See pts. II.D.1 & II.D.2, *ante*.)

First, we give little weight to the name "Facilities Lease" in evaluating the true character of that document.

Second, we conclude the terms in the Facilities Lease regarding the construction, payment, use, occupancy, possession and ownership of the new facilities adequately support Davis's allegation that the arrangement is not a true lease that provided financing for the project.

The Facilities Lease included Contractor's agreement to build facilities for Fresno Unified in exchange for a guaranteed maximum price of $36.7 million. The amount of Fresno Unified's monthly payments to Contractor were based on the progress of the construction. The final payment for the construction became due upon the completion

and acceptance of the construction. Once the final payment was made, both the Facilities Lease and the Site Lease terminated.

Generally, the payment terms set forth in a contract are an important part of the substance of a transaction and directly relevant to whether the transaction is a true lease or a purchase. (See *Offner*, *supra*, 19 Cal.2d at p. 486.) Here, the payment terms were identified in the Construction Provisions as progress payments for construction services and the amount paid each month was determined by the value of construction services completed, less a 5 percent retention. This type of payment schedule is common in construction contracts. (See 4 Miller & Starr, Cal. Real Estate Forms (2d ed. 2006) § 4:4, pp. 36-61 [90% progress payments and a 10% retention used in construction agreement based on cost plus a percentage fee of the guaranteed maximum price].) In contrast, payments made under a lease usually are correlated to a period (e.g., monthly) during which the lessee occupies and uses the real property. (See Black's Law Dictionary, *supra*, p. 970 [defines lease as a "contract by which a rightful possessor of real property conveys the right to use and occupy the property in exchange for consideration, usu. rent"].)

Consequently, the substance of the payment terms in the Facilities Lease is that of compensation for construction, not payment for a period of use of the facilities. Moreover, the payment terms support the allegation that Contractor did not provide any financing to Fresno Unified under the Facilities Lease. Thus, the payment terms and the lack of financing support the allegation that the Facilities Lease was not a genuine lease.

Besides the payment terms, the provisions in the Facilities Lease addressing Fresno Unified's right to occupy and use of the new facilities and its ownership of those facilities shows the true character of the Facilities Lease is something other than a lease. The Facilities Lease stated that, during its term, Fresno Unified would obtain title to the project as construction progresses and corresponding payments were made to Contractor. Also, any remaining right, title or interest in the project and site was transferred to Fresno

Unified upon it making the final payment. Thus, the combination of a relatively short payment schedule and the transfer of title when the final payment was made meant that (1) Contractor never acted in the capacity of a landlord holding rights to real property occupied by a tenant and (2) Fresno Unified never occupied and used the new facilities as a tenant. In addition to these provisions in the Facilities Lease, Davis specifically alleged that Fresno Unified did not have the right or practical ability to occupy and use the new facilities during the term of the Facilities Lease.

The provisions about use, occupancy and title, and the fact that Fresno Unified never occupied and used the project before making its final payment, provide sufficient support for Davis's legal theory that the substance of the transaction was a traditional construction contract and not a true lease that included a financing component. (Cf. 4 Miller & Starr, Cal. Real Estate Forms, *supra*, § 4:5, p. 115 [provision in construction contract addressing title to labor, materials and equipment states all title thereto will pass to the owner upon receipt of payment by contractor].)

Therefore, we conclude that Davis's allegations are sufficient to state a cause of action for a violation of the competitive bidding requirements in section 17417 or Public Contract Code section 20111.

4. Use During the Term of the Lease

Davis's first cause of action also alleges the Lease-Leaseback Contracts violated the statute because they did not require Contractor "to construct on the demised premises ... buildings for the use of the school district *during the term of the lease*." (§ 17406(a)(1), italics added.) Davis interprets this statutory text to mean Fresno Unified was required to use the newly constructed buildings "during the term of the lease." He contends he adequately alleged that Fresno Unified failed to satisfy this criterion. This legal theory presents other issues of statutory interpretation that have not been addressed in a published decision.

Our analysis of the statutory language begins with the meaning of the word "use" that appears in the prepositional phrase "for the use." In the context of a building, we conclude "use" refers to the occupation and utilization of the building in school operations.

Next, we consider the meaning of the prepositional phrase "of the school district," which follows immediately after the phrase "for the use." (§ 17406(a)(1).) We conclude the phrase "of the school district" signals who must "use" the buildings constructed on the leased premises. Thus, the wording "for the use of the school district" is the equivalent of the phrase "for the school district's use." Consequently, the building constructed pursuant to the instrument referred to in section 17406(a)(1) must be used by the school district and not another entity.

The phrase "during the term of the lease" follows immediately after the wording "for the use of the school district." (§ 17406(a)(1).) We conclude this phrase modifies the word "use" by identifying *when* the school district's use must occur. Defendants appear to argue that the phrase modifies only "to construct" and its sole function is to identify when the construction must occur. We reject this interpretation based on the syntactic canon of statutory construction labeled by Scalia & Garner, Reading Law: The Interpretation of Legal Text (2012) as the nearest-reasonable-referent canon: "When the syntax involves something other than a parallel series of nouns or verbs, a prepositive or postpositive modifier[11] normally applies only to the nearest reasonable referent." (*Id.* at p. 152.) In section 17406(a)(1), the terms "to construct" and "for the use" are not parallel phrases. Thus, under the nearest-reasonable-referent canon, the language in the phrase "buildings for the use of the school district during the term of the lease" should be interpreted so that the words "during the term of the lease" modify "the use of the school

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11 Here, the phrase in question is postpositive because it is positioned after both the word "construct" and the word "use." (Scalia & Garner, *supra,* at p. 148.)

district"—the phrase to which they are nearest. Consequently, for a leaseback arrangement to qualify for the exception to the competitive bidding requirement, there must be a lease term during which the school district, as tenant, makes use of the newly built facilities. If, from a substantive point of view, there is no period during which the school district uses the new facilities while leasing them from the construction firm, the arrangement does not conform to the requirements of section 17406 and, therefore, would be subject to the competitive bidding procedures.

This interpretation is consistent with the Attorney General's statutory construction of the predecessor section 17406, former section 15705. (56 Ops.Cal.Atty.Gen., *supra,* at pp. 579-581; see Stats. 1959, ch. 2, § 1, pp. 1086-1087.) Under the heading "*Leasing a completed school building*," the Attorney General stated:

> "Because a school district is not required to obtain bids for lease arrangements under section 15705, it may lease its property for the purpose of permitting *the construction thereon of school buildings which the district will lease* at such rental rates as the governing board deems in the best interests of the district without reference to competitive bidding." (56 Ops.Cal.Atty.Gen., *supra,* at p. 581, italics added.)

Defendants argue that because the legislation identifies a maximum term of 40 years (§ 17403) and provides for no minimum term for leases related to the construction of buildings, this court should infer that the Legislature did not intend a minimum length for the leaseback of the newly built facilities from the construction firm to the school district. (See *Imperial Merchant Services, Inc. v. Hunt* (2009) 47 Cal.4th 381, 389 [*expressio unius est exclusio alterius* is a maxim of statutory construction that means the express inclusion of one thing implies the exclusion of the other].) This maxim of statutory construction supplies an inference about intent based on legislative silence. Here, section 17406(a)(1) contains an explicit requirement that the school district use the new buildings "during the term of the lease." The Legislature's reference to "the term of the lease" and the principle that words indicate substance support the inference that the

Legislature intended this language to have substance, rather than merely specifying a formal or a de minimis requirement.[12]

In summary, a lease-leaseback arrangement qualifies for the exception to competitive bidding created by section 17406(a)(1) only if the instrument containing the leaseback requires the construction firm "to construct on the demised premises ... a building or buildings for the use of the school district during the term of the lease." We interpret this statutory language to mean the leaseback must have a term during which the school district uses the new buildings.

5. Sufficiency of the Particular Facts Alleged

The next step of our analysis is to review the FAC to determine whether Davis has alleged facts sufficient to support his legal theory that the Facilities Lease was subject to competitive bidding because Fresno Unified failed to satisfy the statutory criterion for use of the buildings by the school district "during the term of the lease." (§ 17406(a)(1).)

Paragraph 24 of the FAC alleged that Fresno Unified "does not have the right or practical ability to have beneficial occupancy of the demised premises during the term of the Facilities Lease to use them for their intended purposes."

This allegation, which was made before the completion of the project and termination of the leases, directly addresses whether the Facilities Lease provided for the construction of "buildings for the use of the school district during the term of the lease." (§ 17406(a)(1).) Treating this allegation as true for purposes of the demurrer (*Dinuba*,

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12 The allegations in the FAC, which were confirmed by Fresno Unified's counsel during oral argument, do not present a situation where the school district used the project during a very short leaseback period. Thus, we are not presented with the question of how long the leaseback period must be to qualify for the exception in section 17406, an issue that could be rephrased as how long a district use and occupy the project as a tenant before the "true character" of the transaction is a lease and not a traditional construction contract. (See *Parke etc. Co. v. White River L. Co.*, *supra,* 101 Cal. at p. 39; Civ. Code, § 3533 [the law disregards trifles]; *Miller v. Williams* (1901) 135 Cal. 183, 184 [de minimis principle].)

supra, 41 Cal.4th at p. 865), we conclude Davis has adequately alleged the Facilities Lease did not satisfy a criterion of section 17406(a)(1) because it did not provide for Fresno Unified to use the new constructed buildings during the term of the lease.

E. Summary Regarding Competitive Bidding

We conclude the first and third causes of action[13] adequately allege that defendants violated the statutory requirements for competitive bidding because the Lease-Leaseback Contracts failed to "truly satisfy the statutory criteria" for the exception to competitive bidding set forth in section 17406(a)(1). (*Marshall v. Pasadena Unified School Dist.*, *supra*, 119 Cal.App.4th at p. 1256.) Specifically, Davis has alleged (1) the exception is available only for genuine leases and the subject leaseback agreement was simply a traditional construction agreement, (2) the Lease-Leaseback Contracts did not include a financing component for the construction of the project, and (3) the Lease-Leaseback Contracts did not provide for Fresno Unified's "use" of the new constructed buildings "during the term of the lease." (§ 17406(a)(1).)

III. IMPROPER USE OF LEASE ARRANGEMENTS WHEN SUFFICIENT FUNDS ARE AVAILABLE—FIFTH CAUSE OF ACTION

A. Allegations and Legal Theories

The FAC's fifth cause of action, like his first, alleges the Lease-Leaseback Contracts were ultra vires and void because they did not comply with certain requirements in the Education Code. These requirements are derived from two separate legal theories or interpretations of the Educations Code.

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13 The first cause of action states a claim based on the legal theory that defendants failed to comply with the requirements of section 170406(a)(1) and, therefore, failed to qualify for the exception to the competitive bidding requirements. The third cause of action alleged defendants violated the competitive bidding requirements in section 17417. Thus, for purposes of the demurrer, we regard the causes of action as setting forth overlapping legal theories and will not address the third cause of action separately.

1. The No-Available-Funds Theory

The first legal theory asserts the lease-leaseback method for completing a school construction project "is only available for use by school districts in California as a means to finance the cost of construction over time when they do not have sufficient immediate funds available to them to cover the cost of construction." Davis alleged this requirement was violated because voter-approved bond sales provided Fresno Unified with "sufficient funds available to it to cover the immediate costs of construction of the Project as they are incurred ...."

2. Leaseback Must Provide Financing Theory

The second legal theory asserts that the statutory scheme authorizing lease-leaseback arrangements "requires the cost of construction be advanced and carried over a period of many years by the party to whom the lease-leaseback contracts are awarded."

We will not analyze this legal theory separately because it is part of the first cause of action. (See pt. II.E, *ante*.)

3. SAB Report

Davis supports his legal theory that lease-leaseback arrangements are permitted only when funding is not otherwise available by referring to a Report of the Executive Officer to the State Allocation Board for its January 28, 2004, meeting (SAB Report).[14] The SAB Report was attached to the FAC as exhibit D and states in part:

> "Sections 17400 et al., including [section] 17406, make up Article 2 of Chapter 4 of Part 10.5 of the [Education Code] entitled Leasing Property. It describes the requirements imposed on school districts considering the acquisition of school facilities through lease agreements. As confirmed by the Appeals Court ruling in [*Morgan Hill Unified School District v.*

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[14] The State Allocation Board and the staff of the Office of Public School Construction implement and administer California's school facilities construction program, which includes apportioning money from a state fund and determining which schools are eligible to receive funding. (See *Sanchez v. State of California* (2009) 179 Cal.App.4th 467, 473-474.)

Amoroso, supra, 204 Cal.App.3d 1083], the article is about financing. In that case the court stated that, 'The Education Code creates the following method for financing school construction.' The court then went on to describe ... Sections 39300 through 39325, which are now renumbered as 17400 through 17425. Thus [sections] 17400 through 17425 is a method of financing school construction in which [section] 17406 addresses the mechanism by which the school district can let the property where the construction will take place.

"Staff believes that virtually none of the projects currently using lease-leaseback arrangements actually have financing provided by the developer. If a 'lease agreement' other than the site lease exists at all, it serves no significant purpose other than as a construction contract. The full cost of the project is borne by the district using normal funds it has available for capital projects. Normal progress payments are made to the contractor through the course of construction, and the project is completely paid for by the district at the project completion. The projects are in every regard typical public works projects, except that they have not been competitively bid.

"Since no financing exists in the lease lease-back arrangement (or there is no lease agreement at all), the use of Article 2 appears to be inappropriate."

4. Defendant's Arguments

Defendants argue the express requirements of section 17406 were met in this case. As to the SAB Report, defendants contend the opinions expressed in it should be given little weight because (1) the interpretation of the statutes involves a pure issue of law and this type of interpretation is solely a judicial function; (2) the SAB Report was not formally adopted by the State Allocation Board and was not vetted in accordance with the California Administrative Procedures Act; and (3) subsequent legislation that sought to address some of the issues raised in the SAB Report never became law because of a Governor veto of Assembly Bill No. 1486 (2003–2004 Reg. Sess.).

B. Analysis

We reject Davis's legal theory that the statutory scheme restricts the use of lease-leaseback arrangements to situations where the school district does not have sufficient available funds to cover the cost of building the new facilities.

First, there is no express provision in the statutes limiting school district's use of lease-leaseback arrangements to situations where the school district funds are not otherwise available.

Second, Davis has identified no ambiguous provision in the statutes that could be construed in a manner to include such a broad limitation. Although exceptions to competitive bidding are to be narrowly construed, the concept of strict construction does not empower courts to narrow the scope of the statutory exception by imposing conditions or limitations the Legislature did not include in the statute. (See Code Civ. Proc., § 1858 [courts interpreting a statute should not "insert what has been omitted" by the Legislature].)

Third, the views expressed in the SAB Report do not actually include the interpretation advocated by Davis. Specifically, the SAB report does not state that the legislation restricts the availability of the lease-leaseback method to situations where other funding is not available. In other words, the report's reference to a case stating the "Education Code creates the following method for financing school construction" (*Morgan Hill Unified School Dist. v. Amoroso*, *supra*, 204 Cal.App.3d at p. 1086) does not imply that method is allowed only if other methods of financing are not available.

IV. BREACH OF FIDUCIARY DUTY—SECOND CAUSE OF ACTION

A. Allegations

The FAC's second cause of action alleged that Fresno Unified's board had a fiduciary duty to the residents and taxpayers within Fresno Unified and that duty applied to the board's approval of expenditures for a multi-million dollar construction project. The FAC also alleged Fresno Unified's board breached the fiduciary duty by (1) failing to consider less expensive alternatives to the project, (2) failing to consider whether the price was reasonable, (3) failing to exercise due diligence to determine whether the price paid could be lower, (4) knowing the price paid could have been lower, (5) failing to

solicit bids for the work, (6) failing to proceed in a manner that would secure the best price, and (7) failing to proceed in a manner required by law. In short, Davis alleged Fresno Unified's board breached its fiduciary duty by overpaying for the project.

The FAC contends that because Fresno Unified did not comply with its fiduciary duties, the Lease-Leaseback Contracts are ultra vires, void and unenforceable and "all money paid thereunder must be returned by CONTRACTOR to DISTRICT."

B. Breach of Fiduciary Duty

In litigation between private parties, the elements of a cause of action for breach of fiduciary duty are (1) the existence of a fiduciary duty, (2) a breach of the fiduciary duty, and (3) damage proximately caused by the breach. (*Gutierrez v. Girardi* (2011) 194 Cal.App.4th 925, 932.) When a claim for breach of fiduciary duty is asserted against a public official by the Attorney General or a taxpayer, the damage element can be satisfied by alleging the official obtained profits from the unauthorized act. (*People ex rel. Harris v. Rizzo* (2013) 214 Cal.App.4th 921, 950 [breach of fiduciary duty claim stated against council members who paid themselves excessive salaries].) In these cases, the relief available is restitution, which can include the disgorgement of profits obtained by the public official. (*Id.* at p. 951, fn. 30.)

C. Analysis

Here, the FAC requests that Contractor return all money paid to it under the Lease-Leaseback Contracts, but does not allege Contractor was subject to a fiduciary duty. As to the persons who allegedly breached their fiduciary duty (i.e., Fresno Unified's board), the FAC does not allege they profited from the transactions and does not request restitution or the disgorgement of profits. Furthermore, the relief sought for the alleged breach of fiduciary duty is against Contractor, a party who did not have a fiduciary duty. Accordingly, the second cause of action failed to allege facts sufficient to state a claim for breach of fiduciary duty. (See *People ex rel. Harris v. Rizzo*, *supra*, 214

Cal.App.4th at p. 950 [city's police chief who negotiated excessive salary did not breach a fiduciary duty because any duty would have arisen only after the contract was executed; demurrer properly sustained as to cause of action against him].)

V. CONFLICT OF INTEREST—FOURTH CAUSE OF ACTION

Davis's fourth cause of action attempts to state a conflict of interest claim based upon (1) common law conflict of interest principles, (2) Government Code section 1090 et seq. and (3) the provisions of California's Political Reform Act of 1974, Government Code section 81000 et seq.

A. Political Reform Act of 1974

1. Conflict of Interest Provisions

Chapter 7 of the Political Reform Act of 1974[15] addresses conflicts of interest by public officials. This chapter contains Government Code section 87100, which states: "No public official at any level of state or local government shall make, participate in making or in any way attempt to use his official position to influence a governmental decision in which he knows or has reason to know he has a financial interest."

The term "public official" is defined for purposes of the Political Reform Act of 1974 to mean "every member, officer, employee or *consultant* of a state of local government agency." (Gov. Code, § 82048, subd. (a), italics added.)

2. Allegations in FAC

The FAC contains the following allegations. Contractor had a prior contract with Fresno Unified that created a conflict of interest and, therefore, precluded Contractor from being awarded the Lease-Leaseback Contracts. Pursuant to the prior contract,

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15 The act contains Government Code sections 81000 through 91014 and is designated title 9 of that code. Chapter 7 contains eight articles consisting of Government Code sections 87100 through 87505. This detail about title 9 and its chapters is provided because the definition of "public official" in chapter 2 is used to determine the reach of the conflict of interest provisions in chapter 7.

Contractor acted as a consultant and provided Fresno Unified with professional preconstruction services related to the project, which included the development of plans, specifications and other construction documents for the project. Contractor was paid by Fresno Unified for consulting on the project and had a hand in designing and developing plans and specifications by which the project is being constructed.

The FAC referred to Government Code section 81000 et seq., but not the specific provision that contains the prohibition against conflicts of interest, Government Code section 87100. The FAC also cited the definition of "public official" in Government Code section 82048, subdivision (a).

3. The Demurrers, Opposition and Replies

The demurrers of Fresno Unified and Contractor address the conflict of interest claim under the Political Reform Act of 1974 by asserting (1) it was enacted so that public officials would perform their duties in an impartial manner without bias caused by their own financial interest and (2) elected officials are required to file annual statements disclosing their financial interests. Defendants argued Davis did not and could not allege Contractor was an elected official or even a designated official to whom the act would apply. They quote a bylaw of Fresno Unified that requires persons in designated positions to file a full statement of economic interest and then assert Contractor is not one of the designated officials. From this foundation, defendants contend the "Political Reform Act of 1974 simply does not apply to [Contractor] in this case."[16]

In his opposition, Davis cited Government Code section 87100, the conflict of interest provision in the Political Reform Act of 1974, and relied on its requirement that no public official shall participate in making a governmental decision in which the

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16 Defendants cite Government Code sections 87203 (annual statement) and 87207 (income statement). These citations are off the mark because the sections are in the article addressing disclosure, not the article containing the prohibition against a conflict of interest.

official knows he has a financial interest. One implication of Davis's reference to "no public official" is that the conflict of interest provision is not limited to the *elected* and *designated* officials described in the demurrers.

Defendants' reply papers ignored the statutory language in Government Code section 87100 and the definition of "public official" in Government Code section 82048, subdivision (a) that extends to consultants. The replies reasserted that Davis "has not alleged and cannot allege [Contractor] is an elected official or even a designated official that the Act would apply."

The minute order sustaining the demurrer to the conflict of interest cause of action mentioned Government Code section 1090, but did not refer to Government Code section 87100 or the statutory definition of public official that includes consultants.

4. A Corporate Consultant Is Not a Public Official

The definition of "public official" in Government Code section 82048, subdivision (a), unambiguously applies to all of the Political Reform Act of 1974, including its prohibition against conflicts of interest. Specifically, Government Code section 82000 states that the definitions set forth in chapter 2 of the Political Reform Act of 1974 govern the interpretation of title 9, which title contains all provisions of the Political Reform Act of 1974. Therefore, the public officials mentioned in the conflict of interest provision include consultants. (See Gov. Code, § 82048, subd. (a) ["public official" defined to include consultants].)

Thus, Davis's allegation that Contractor provided services to Fresno Unified as a paid consultant is sufficient to raise the possibility that Contractor was a "public official" subject to conflicts of interest in Government Code section 87100.

The term "consultant" is not defined by the Political Reform Act of 1974, but the regulations promulgated under the act contain a definition. (See League of California Cities, Cal. Municipal Law Handbook (Cont. Ed. Bar 2014) § 2.114, p. 155 [consultant included in list of key definitions].) A consultant is "an individual who, pursuant to a

contract with a state or local government agency [¶] (1) [m]akes a governmental decision ...." (Cal. Code Regs., tit. 2, § 18704.6, subd. (a).) The appellate briefing has not mentioned this regulatory definition and, consequently, Davis has not argued the regulation is invalid. (See Gov. Code, § 11342.2 [no regulation is valid unless consistent and not in conflict with the statute].) Therefore, we accept the regulatory definition of "consultant" as valid and applicable to this case.

Davis alleged that Contractor "is, and at all times mentioned was, a California corporation, doing business in the City of Fresno and State of California." As a corporation, Contractor falls outside the regulatory definition of "consultant" that refers to individuals. Therefore, we conclude Contractor is not a "public official" subject to the conflict of interest provisions in the Political Reform Act of 1974.

It follows that the FAC failed to state a cause of action against Contractor for violating the conflict of interest prohibition in Government Code section 87100.

B. Government Code Section 1090

1. Basic Principles Governing Conflict of Interest Claims

Government Code section 1090, subdivision (a) provides in part: "Members of the Legislature, state, county, district, judicial district, and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members." One of the consequences for a civil violation of this rule is set forth in Government Code section 1092: "(a) Every contract made in violation of any of the provisions of [Government Code] Section 1090 may be avoided at the instance of any party except the officer interested therein."[17]

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17 The term "any party" is not restricted to parties to the contract. Defendants did not base their demurrer on the ground Davis lacked standing to bring the conflict of interest claim under Government Code section 1090 since it is recognized that either the public agency or a taxpayer may seek relief for a violation of section 1090. (E.g., *Thomson v. Call* (1985) 38 Cal.3d 633 [taxpayer suit successfully challenged validity of land transfer

Government Code section 1090 "codifies the long-standing common law rule that barred public officials from being personally financially interested in the contracts they formed in their official capacities." (*Lexin v. Superior Court* (2010) 47 Cal.4th 1050, 1072 (*Lexin*).) The prohibition is based on the rationale that a person cannot effectively serve two masters at the same time. "'If a public official is pulled in one direction by his financial interest and in another direction by his official duties, his judgment cannot and should not be trusted, even if he attempts impartiality.' [Citation.]" (*Id.* at p. 1073.) Consequently, Government Code section 1090 is designed to apply to any situation that "would prevent the officials involved from exercising absolute loyalty and undivided allegiance to the best interests of the [public entity concerned]." (*Stigall v. City of Taft* (1962) 58 Cal.2d 565, 569 (*Stigall*).) Government Code section 1090's goals include eliminating temptation, avoiding the appearance of impropriety, and assuring the public of the official's undivided and uncompromised allegiance. (*Thomson v. Call, supra,* 38 Cal.3d at p. 648.)

Courts evaluating a conflict of interest claim under Government Code section 1090 must consider "(1) whether the defendant government officials or employees participated in the making of a contract in their official capacities, (2) whether the defendants had a cognizable financial interest in that contract, and (3) (if raised as an affirmative defense) whether the cognizable interest falls within any one of section 1091's or section 1091.5's exceptions for remote or minimal interests. [Citations.]" (*Lexin*, *supra*, 47 Cal.4th at p. 1074.)

The breadth of what it means to participate in the making of a contract is illustrated by *Stigall*. In that case, a taxpayer filed an action seeking to have a contract for plumbing work related to construction of a civic center declared invalid. (*Stigall*,

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from city council member through intermediaries to city]; see Kaufmann & Widiss, *The California Conflict of Interest Laws* (1963) 36 So.Cal. L.Rev. 186, 200.)

supra, 58 Cal.2d at p. 566.) The trial court sustained a demurrer to the complaint, concluding the taxpayer failed to allege facts showing a prohibited conflict of interest. The Supreme Court reversed and directed the demurrer to be overruled. (*Id.* at p. 571.)

In *Stigall*, the complaint alleged the member of the city council in charge of the council's building committee owned more than 3 percent of the stock of a plumbing company and the building committee supervised the drawing of plans and specifications for a civic center. (*Stigall*, *supra*, 58 Cal.2d at pp. 566-567.) When the bids for the construction work were received and opened, the council member's plumbing company was the low bidder for the plumbing work. (*Id.* at p. 567.) After objections were made to awarding the contract to the council member's plumbing company, the council rejected all bids and advertised for new round of bidding. (*Ibid.*) Subsequently, the council member resigned and the council awarded the construction contract to a general contractor that had included a sub-bid for the plumbing work from the former council member's plumbing company. (*Ibid.*)

The Supreme Court addressed the timing of the council member's resignation and whether he "made" the contract entered into by the plumbing company. (*Stigall*, *supra*, 58 Cal.2d at pp. 568-569.) The court determined the use of technical terms and rules governing the making of contracts was not appropriate and construed the word "made" broadly in light of the statutory objective to "limit the *possibility* of any personal influence, either directly or indirectly which might bear on an official's decision." (*Id.* at p. 569.) The court concluded the term "made" encompassed the planning, preliminary discussions, and drawing of plans and specification. (*Id.* at p. 571.) Because the former council member had participated in all of these activities involving the contract and was financially interested in the plumbing company, the court concluded the complaint alleged a violation of the conflict of interest provision in Government Code section 1090.

2. Contentions

Davis contends that the conflict of interest provision in Government Code section 1090 extends to independent contractors and consultants who are involved in the contract process on behalf of the public entity and have an interest in the resulting contract. Davis relies on two decisions that applied the conflict of interest provision to independent contractors and consultants. (See *Hub City Solid Waste Services, Inc. v. City of Compton* (2010) 186 Cal.App.4th 1114, 1124-1125 (*Hub City*); *California Housing Finance Agency v. Hanover/California Management & Accounting Center, Inc.* (2007) 148 Cal.App.4th 682, 693 (*Hanover*).)

Defendants contend *Hub City* and *Hanover* are readily distinguishable from the facts pled in the FAC and, in any event, the expansion of liability adopted in those cases has been harshly criticized by the court in *People v. Christiansen* (2013) 216 Cal.App.4th 1181, at pages 1189 through 1190. Defendants also contend that section 17250.10 demonstrates that the Legislature is not concerned with situations where a single entity acts as both the designer and builder of the same project.[18]

3. Analysis

Government Code section 1090 applies to district "officers or employees." The decisions in *Hub City* and *Hanover* extended the conflict of interest prohibition to consultants, but did not address whether, for purposes of Government Code section 1090, *corporate* consultants could be regarded as "officers or employees" of the local agency.

In *Hanover*, the conflict of interest claims were pursued against two individuals and not against the corporation that actually entered into the contact with the public agency. (*Hanover*, *supra*, 148 Cal.App.4th at p. 684.)

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[18] Fresno Unified and Contractor did not utilize the design-bid procedures contained in sections 17250.10 through 17250.50. Therefore, even if that legislation is interpreted as creating an exception to the conflict of interest provisions, the exception would not apply to Contractor in this case.

In *Hub City*, the appellants challenged the adverse judgment on a conflict of interest claim by arguing that corporate consultants do not owe municipalities a fiduciary duty. (*Hub City*, *supra*, 186 Cal.App.4th at p. 1125.) The court did not decide this argument, concluding that the limited liability company's status as the contracting entity with the city was immaterial because the actions of the company's president fell within the scope of Government Code section 1090. (*Hub City, supra,* at p. 1127.) Thus, the court's decision was based on the fact the president of the consulting company was an "officer" under the statute and his individual actions influenced the city's contracting decisions. (*Id.* at p. 1125.) As to the evidence presented, the court concluded it established that the president's actions fell within the ambit of Government Code section 1090 because he was intricately involved in the city's waste management decisions and proposed franchising the city's waste management decisions. (*Hub City, supra,* at p. 1125.) As a result, the subsequent franchise agreement between the city and another of the president's companies was invalidated.

In summary, the courts in *Hanover* and *Hub City* interpreted the statute broadly to include individuals who were consultants to the public agency, but neither court decided whether the statutory terms "officers" or "employees" should be expanded to include legal entities such as corporations or limited liability companies.

First, we conclude that the stricter definition of the statutory terms adopted by the court in *People v. Christiansen*, *supra*, 216 Cal.App.4th 1181 is appropriate in the context of criminal prosecution, but is not appropriate in the context of civil actions seeking to invalidate a contract with a public entity. In *Stigall*, a civil action, the Supreme Court interpreted the statutory terms broadly to implement to objectives of the conflict of interest statute and did not rely on technical definitions or rules to limit the reach of the statute. Similarly, we conclude that technical definitions of the term "employee" taken from other areas of law should not be used to limit the scope of Government Code section 1090. Therefore, we join the courts in *Hanover* and *Hub City* in concluding that, in civil

actions, the term "employees" in Government Code section 1090 encompasses consultants hired by the local government.

Second, as to whether the word "employees" should be interpreted to exclude corporate consultants, we conclude that corporate consultants should not be categorically excluded from the reach of Government Code section 1090. Such a statutory interpretation would allow the use of the corporate veil to insulate conflicts of interest that otherwise would violate the prohibition against local government officers and employees from making contracts in which they are financially interested. A corporate consultant is as capable of influencing an official decision as an individual consultant. Because the statute's object is to limit the *possibility* of any influence, direct or indirect, that might bear on an official's decision (*Stigall*, *supra*, 58 Cal.2d at p. 570), we conclude the allegations that Contractor served as a professional consultant to Fresno Unified and had a hand in designing and developing the plans and specifications for the project are sufficient to state that Contractor (1) was an "employee" for purposes of Government Code section 1090 and (2) participated in making the Lease-Leaseback Contracts.

Third, the FAC alleged that Fresno Unified and Contractor entered into the Lease-Leaseback Contracts pursuant to which Contractor agreed to build the project for a guaranteed maximum price of $36.7 million. These allegations are sufficient to state that Contractor was "financially interested in" the Lease-Leaseback Contracts for purposes of Government Code section 1090.

In summary, Davis has alleged sufficient fact to state of cause of action for a violation of the conflict of interest provisions in Government Code section 1090. Contrary to defendants' argument, it does not appear that a plaintiff is required to include detailed allegations of actual influence on the decision to award the contract in question. (See *Stigall*, *supra*, 58 Cal.2d 565.) Ultimately, whether Davis will be able to prove Contractor violated the conflict of interest provision of Government Code section 1090

will depend upon the facts established by the evidence. For purposes of demurrer, Davis has alleged sufficient facts to state a cause of action.

C. Common Law Conflict of Interest

In *Lexin*, the Supreme Court stated that Government Code section 1090 "codifies the long-standing common law rule that barred public officials from being personally financially interested in the contracts they formed in their official capacities." (*Lexin*, *supra*, 47 Cal.4th at p. 1072.) The statutes' overlap with the common law rule is not completed because the statutes are concerned with *financial* conflicts of interest and the common law rule encompassed both financial and nonfinancial interests that could result in divided loyalty. (See *Clark v. City of Hermosa Beach* (1996) 48 Cal.App.4th 1152, 1171, fn. 18 [Political Reform Act of 1974 focuses on financial conflicts of interest while the common law extended to noneconomic conflicts of interest].)

Because we have concluded the FAC stated a cause of action under Government Code section 1090, it follows that Davis also has stated a common law claim for a conflict of interest.

VI. DECLARATORY RELIEF

Davis's seventh cause of action is based on the previously alleged violations of the Education Code and the need for competitive bidding. This declaratory relief claim depends upon the other causes of action and does not set forth an independent basis for relief. Because we have determined that some causes of action stated facts sufficient to allege a claim, we will allow the request for declaratory relief to remain part of the litigation.

DISPOSITION

The judgment is reversed. The trial court is directed to vacate its order sustaining the demurrer and enter a new order (1) sustaining the demurrer as to the breach of fiduciary duty claim, the violation of the Political Reform Act of 1974 claim, and the fifth

cause of action alleging the use of the lease-leaseback arrangement is improper when funds are available to a school from another source and (2) overruling the demurrer as to the other causes of action.

Plaintiff shall recover his costs on appeal.

Franson, J.

WE CONCUR:

Levy, Acting P. J.

Gomes, J.

PROOF OF SERVICE

STATE OF CALIFORNIA)
) **SS**
COUNTY OF FRESNO)

I am a citizen of the United States and a resident of the County aforesaid; I am over the age of eighteen (18) years and not a party to the within-entitled action. My business address is 8080 North Palm Avenue, Third Floor, Fresno, CA 93711. On July 13, 2015, I served the within document(s):

PETITION FOR REVIEW

☒ **BY MAIL:** By placing the document(s) listed above in a sealed envelope with postage thereon fully prepaid, in the United States mail at Fresno, California, addressed as set forth below.

Kevin R. Carlin, Esq. SBN 185701 Carlin Law Group, APC 4452 Park Boulevard, Suite 310 San Diego, CA 92116 Telephone: (619) 615-5325 **Attorney for Plaintiff/Respondent Stephen K. Davis**	Martin A. Hom and Jennifer Cantrell Atkinson, Andelson, Loya, Ruud & Romo 5260 N Palm Ave # 300 Fresno, CA 93704 (559) 225-6700 **Attorneys for Defendant and Respondent Fresno Unified School District**
Frank Joseph Lozoya, IV Lozoya & Lozoya 15060 Ventura Blvd., # 211 Sherman Oaks, CA 91403 Tel. (818) 789-7150 **Attorneys for Defendant/Respondent Harris Construction**	Ryan Keats Sean M. SeLegue Arnold & Porter LLP Three Embarcadero Center Tenth Floor San Francisco, CA 94111 Telephone: (415) 471-3370 **Attorneys for Defendant/Respondent Harris Construction**

Anthony N. Kim Cory J. Briggs Mekaela M. Gladden Briggs Law Corporation 99 East "C" Street, Ste. 111 Upland, CA 91786 (909) 949-7115 **Attorneys for Kern County Taxpayers Association as Amicus Curiae on behalf of Plaintiff and Appellant**	James Richard Traber Fagen Friedman & Fulfrost 520 Capitol Mall Suite 400 Sacramento, CA 95814 (916) 443-0000 **Attorneys for California's Coalition for Adequate School Housing: Amicus Curiae for Respondent**
Hon. Donald S. Black Fresno County Superior Court Department 502 1130 O Street Fresno, CA 93724	Court of Appeal Fifth Appellate District (*via e-service pursuant to California Rules of Court, Rule 8.212, by e-submission to Court of Appeal, Fifth District*)

I am readily familiar with the firm's practices of collection and processing of correspondence for mailing. Under that practice, it would be deposited with the United States Postal Service on that same day with postage thereon fully prepaid in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if postal cancellation date or postage meter date is more than one day after date of deposit for mailing in affidavit.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed on July 13, 2015, at Fresno, California.

Helen Walton

Helen L. Walton