

***The* COMMUNITY COLLEGE UPDATE**

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Volume 35 For Publication Date: June 12, 2015 No. 12
**Recent Court Opinion Regarding Lease-Leaseback May Impact
Community Colleges**

A new opinion by the California Court of Appeal, Fifth Appellate District (Court) (*Davis v. Fresno Unified School District*) was released on June 1, 2015. While the primary focus of the opinion centered on K-12 school districts' ability to access an exception to public works competitive bidding requirements, it does touch upon conflict of interest issues that could affect community college districts.

The Education Code (E.C.)—through a mechanism commonly known as lease-leaseback—allows both school districts (E.C. 17406) and community college districts (E.C. 81335) to enter into leases for real property belonging to the district for a minimum of \$1 per year. The lease must require the lessee to construct or provide for the construction of a building(s) that will be used by the district during the term of the lease, and must provide that title to the building(s) vest with the district at the expiration of the lease term.

The difference between the statutes for school districts and community college districts is found in four critical words—without advertising for bids—which are present in the statute for school districts, but absent in the statute for community college districts. These four words allow school districts to enter into lease-leaseback agreements without the requirement to competitively bid projects. Because this exception to competitive bidding for school districts is not mirrored in the statutes for community colleges, the impact of the Court's opinion is more significant for school districts, but community college districts should be aware of another issue addressed by the Court relating to conflicts of interest.

Of interest to community colleges, the Court's opinion addresses two allegations made by the plaintiff: (1) if lease-leaseback is an allowable financing mechanism when other funds are available; and (2) if there was a conflict of interest on the part of the contractor, who prior to the execution of the lease-leaseback contract served as a consultant to the district. In response to the first allegation, the Court rejected the plaintiff's assertion that lease-leaseback can only be utilized when a school district does not have sufficient funds available for construction of new facilities. The Court found that 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."

In response to the second allegation, the Court found that the plaintiff had provided "sufficient facts to state a cause of action for a violation of the conflict of interest provisions in Government Code Section 1090" and addresses two relevant issues. First, the Court recognized prior case law, which established that conflict of interest laws in the Government Code that traditionally apply to officers and employees of local agencies also apply to consultants hired by local agencies. The Court in this case, however, extended the conflict of interest provisions to corporate consultants, deeming that "corporate consultant[s] are just as capable of influencing an official decision as an individual consultant[;]" therefore, concluding that that the Fresno Unified School District

contractor, who served as a professional consultant to the district and assisted in the design and development of the project plans and specifications, met the statutory definition of a local agency “employee” subject to conflict of interest limitations. However, the Court does stipulate that whether or not the plaintiff is able to prove a violation will depend on the facts established by the evidence.

As it pertains to K-12 school districts—though community college districts should also be aware of these requirements—the Court finds that in order for a school district to utilize E.C. 17406 and avail itself of the exception to competitively bid projects, three things must be present:

1. A genuine lease—Per the Court, a lease “refers to the substance of the transaction and means more than a document designated a lease by the parties.” In determining whether the lease in question was a genuine lease, the Court reviewed the terms of the “lease” in this case (i.e., construction, payment, use, occupancy, possession, and ownership of the new facilities) and determined that it did not meet the criteria necessary to be considered a lease (see items 2 and 3 below) and, therefore, the “substance of the transaction was a traditional construction contract and not a true lease that included a financing component.”
2. A financing component—The Court concludes that the primary purpose of E.C. 17406 is to provide an alternative source of financing for the construction of schools. A lease-leaseback contract provides for a contractor to be compensated for the costs of construction and financing of a project, while allowing a school district to acquire facilities that it might not be able to pay for using traditional methods and spreading its obligation to pay for the project over a period of time. In this case, the school district paid for the construction of the facilities as construction progressed and made a final payment when construction was completed. Thus the contract entered into and executed by Fresno Unified School District included a compensation for construction rather than payment for the use of the facilities, which the Court states “cannot be characterized as a method of financing the construction of new school facilities.”
3. Occupancy of the facilities by the school district—As noted above, E.C. 17406 allows for the construction of buildings “for the use of the school district during the term of the lease.” The Court concludes that for a lease-leaseback “there must be a lease term during which the school district, as tenant, makes use of the newly built facilities.” And if “there is no period during which the school district uses the new facilities while leasing from the construction firm,” then the arrangement does not conform to E.C. 17406. In this case, the school district made final payment at the conclusion of construction and took possession of the property—never leasing the facilities from the contractor upon completion.

To be clear, the Court opinion is not in itself a ruling, but direction to the lower court that originally upheld the school district’s request to dismiss the plaintiff’s complaint. However, the opinion is certified for publication, which means that it can be relied upon by judges when ruling on other court cases. Community college districts should be cognizant of the possibility for conflicts of interest; and, in consultation with their attorneys, should review all existing or pending lease-leaseback agreements in light of this opinion and ensure that the agreements meet the requirements as outlined in E.C. 81335.