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January 29, 2021

Honorable Chief Justice Tani Cantil-Sakauye
and Associate Justices
Supreme Court of California
350 McAllister Street
San Francisco, CA 94102

Re: *Davis v. Fresno Unified School District*, No. S266344: Amicus Curiae Letter of
the League of California Cities in Support of Petition for Review

Honorable Chief Justice and Associate Justices:

INTRODUCTION

The League of California Cities (“Cal Cities”) submits this letter as amicus curiae in support of the petition for review filed by Fresno Unified School District. Specifically, Cal Cities urges the Court to review the Fifth District Court of Appeal’s conclusion that bond-funded construction projects structured as lease-leaseback agreements are potentially not subject to validation, despite the plain language of Government Code section 53511. The decision has far-reaching negative implications for the construction of public projects and the reliability of public finance.

Cal Cities is an association of 477 California cities dedicated to protecting and restoring local control to provide for the public health, safety, and welfare of their residents, and to enhance the quality of life for all Californians. Cal Cities is advised by its Legal Advocacy Committee, comprised of 24 city attorneys from all regions of the State. The Committee monitors litigation of concern to municipalities, and identifies those cases that have statewide or nationwide significance. The Committee has identified this case as having such significance.

Cities rely on lease-leaseback agreements to finance a host of projects and on validation to ensure those projects can be funded at a reasonable cost and completed in a

reasonable time. Without validation, litigation may delay necessary government projects for years, and the possibility of disgorgement will have a chilling effect on bond issuers and contractors. All of which comes at an unnecessary cost to the public.

THE ISSUE IS OF WIDESPREAD SIGNIFICANCE

In *Davis v. Fresno Unified School District* (2020) 57 Cal.App.5th 911, 944 (*Davis II*), the Fifth District Court of Appeals concluded that a lease-leaseback agreement between a contractor and the Fresno Unified School District to build a middle school was not subject to validation. Although Government Code section 53511 declares the validation statutes apply to “an action to determine the validity of [a local agency’s] bonds, warrants, **contracts**, obligations or evidences of indebtedness”, the Fifth District ruled that only those lease-leaseback agreements with a “financing component” counted as “contracts” under the statute. (*Davis II, supra*, 57 Cal.App.5th at p. 944.)

Davis II questions one of the primary financing mechanisms that public agencies across the State use to fund billions of dollars in infrastructure improvements every year. Bond-funded lease-leaseback agreements allow municipalities to fund construction projects while adhering to the debt limitation provisions the California Constitution places on state and local governments. (70 Ops.Cal.Atty.Gen. 57 (1987), n. 2.) Lease-leaseback agreements are vitally important for the construction of public schools, but are also used successfully by cities and counties to finance public buildings of every kind, including courthouses, administrative offices, city halls, parking structures, student housing, stadiums, and theaters. Over time, these projects have included a civic center in the city of Desert Hot Springs,¹ a municipal airport in Sacramento County,² and a twelve-acre park in the heart of downtown Los Angeles.³ Without lease-leaseback arrangements as a tool, the ability of local government to fund such projects will be deeply damaged.

¹ *City of Desert Hot Springs v. County of Riverside* (1979) 91 Cal.App.3d 441

² *Peacock v. Sacramento County* (1969) 271 Cal.App.2d 845, 848

³ 1st and Broadway Civic Center Park Project <<https://eng.lacity.org/1st-and-broadway-civic-center-park-project>>; Civic Park Project Lease-Leaseback Approval <<http://file.lacounty.gov/SDSInter/bos/supdocs/53361.pdf>>

For example, the City of Salinas entered into two lease-leaseback agreements in 2018 to rebuild and expand a public library and construct a new police station.⁴ The current buildings were both over 50 years old and the police station in particular “had significant structural and interior deterioration.” Both projects, which together will cost approximately \$80 million, are on time and under budget through lease-leaseback agreements. The need for effective lease-leaseback agreements goes beyond local government’s efforts to modernize and maintain facilities. Lack of adequate public safety resources, such as functional fire and police stations, can put communities at risk.

Although lease-leaseback agreements provide an important mechanism to finance public projects, such projects also present a serious risk of litigation to contractors, bond issuers, and public funds. Bond issuers require certainty, and the “possibility of future litigation is very likely to have a chilling effect upon potential third party lenders, thus resulting in higher interest rates or even the total denial of credit.” (*McLeod v. Vista Unified School Dist.* (2008) 158 Cal.App.4th 1156, 1168.) Similarly, contractors are rightfully concerned about the risk of judicial invalidation and disgorgement, driving up construction costs for municipalities. And cities may ultimately spend millions of dollars to defend an already completed project.

Local governments therefore consistently use validation to ensure lease-leaseback agreements and other forms of public financing are secure. Validation allows a local agency to initiate an *in rem* proceeding to determine the validity of its contracts, or allow the 60-day time frame for validation to pass knowing that covered contracts are thereafter unassailable. (*City of Ontario v. Superior Court* (1970) 2 Cal.3d 335, 341-342.) Courts have universally held “the validating statutes should be construed so as to uphold their purpose, i.e., the acting agency’s need to settle promptly all questions about the validity of its action.” (*Friedland v. City of Long Beach* (1998) 62 Cal.App.4th 835, 842.)

Validation provides the quick certainty that cities, contractors and bond issuers need to embark on public projects. If validation is unavailable, or even uncertain, the result is increased costs from third parties, who must price in the risk of lengthy litigation and disgorgement, as well as slower completion times and the specter of costly and

⁴ Salinas Finance Department Staff Report, May 18, 2018, <<https://salinas.legistar.com/LegislationDetail.aspx?ID=3498081&GUID=6FA51CC1-9654-4CBD-A91D-E3684976E6AD&Options=&Search=>>

damaging litigation. If bond-funded lease-leaseback agreements are not subject to validation, local agency projects will be slower, costlier, and many will simply not get done at all.

THE OPINION ERRED IN FINDING A BOND-FUNDED PROJECT WAS NOT SUBJECT TO VALIDATION

Beyond having a significant negative impact on vital public services, *Davis II* was wrongly decided. The lease-leaseback arrangement in *Davis II* called for payments to be made as construction progressed, with full payment and termination of the lease at the end of construction. (*Davis II, supra*, 57 Cal.App.5th at p. 916.) The Fifth District Court of Appeal had previously ruled in *Davis v. Fresno Unified School Dist.* (2015) 237 Cal.App.4th 261, 285 (*Davis I*) that this agreement was not a true “lease” because it contained no financing component, and therefore failed to satisfy the criteria in Education Code section 17406, subdivision (a)(1). In *Davis II*, the court was compelled to maintain that earlier position as the law of the case, and found the lease-leaseback agreement was therefore not a contract subject to validation under Government Code section 53511. (*Davis II, supra*, 57 Cal.App.5th at p. 941 fn 15.)

Davis I was roundly criticized, most prominently in *McGee v. Balfour Beatty Construction, LLC* (2016) 247 Cal.App.4th 235, 243 and *California Taxpayers Action Network v. Taber Construction, Inc.* (2017) 12 Cal.App.5th 115, 129 (*Taber*). *Taber* explained that *Davis I* “went far beyond the language of section 17406 in adopting ill-defined additional factors to determine whether the leaseback portion of a lease-leaseback agreement is a ‘true’ lease and imposing a requirement that the contractor provide financing for the project.” (*Taber, supra*, 12 Cal.App.5th at pp. 129–130.)

The Second District Court of Appeal went on in *McGee v. Torrance Unified School District* (2020) 49 Cal.App.5th 814 (*McGee II*) to consider facts identical to those presented in *Davis II*, and came to the opposite conclusion. *McGee II* also concerned progressive payments in a lease-leaseback arrangement to construct a school, and a disagreement on whether the contract was subject validation under Government Code section 53511 — rendering the case moot following completion — or if the plaintiff retained standing under Code of Civil Procedure section 526a and Government Code section 1090. (*McGee II, supra*, 49 Cal.App.5th at pp. 824–828.) The Second District found that lease-leaseback arrangements were a method of financing and that validation applied. (*Id.* at p. 824.) The court was also quick to note the damage plaintiff’s lawsuit had caused, delaying the

project for **years**, and that a judgment in plaintiff’s favor would threaten **future** projects with the prospect of lawsuits long after completion, which “would undoubtedly inhibit the District’s ability to obtain financing for them.” (*Id.* at p. 828.)

Davis II acknowledged *McGee II*, but refused to engage that case’s central holding: Because the lease-leaseback agreement was funded by the district’s general obligation bonds, the contracts “involved the District’s financial obligations and were inextricably bound up in the District’s bond financing, bringing them within the scope of ‘contracts’ covered by Government Code section 53511.” (*McGee II, supra*, 49 Cal.App.5th at p. 824; *McLeod, supra*, 158 Cal.App.4th at p. 1169.) So too for the lease-leaseback agreement in *Davis II*, which the Fifth District declined to reevaluate. (*Davis II, supra*, 57 Cal.App.5th at p. 944.) Without the protection of the validation statutes, the Fifth District went on to find that disgorgement was an appropriate and available remedy. (*Ibid.*) The chilling effect of potential disgorgement on public construction projects cannot be overstated. The specter of a lawsuit up to three years after a project commences (Code Civ. Proc., § 338), rather than within 60-days as envisioned by the legislature, will drive up construction and borrowing costs, scare away competent contractors, and delay or stop numerous, vital projects across the State. This Court’s direction is needed to resolve the split in authority between *McGee II* and *Davis II* on the applicability of the validation statute to bond-funded lease-leaseback agreements.

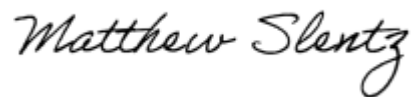
Depublishing *Davis II* will not contain the problems created by this decision. The case has received widespread attention in the legal and construction communities, and contractors and bond issuers are weary of a court invalidating a lease-leaseback agreement years after construction is complete. Further, even if *Davis II* were depublished, *Davis I* would remain precedent. The Fifth District felt its ruling in *Davis I* that Fresno Unified School District’s lease-leaseback arrangement contained no true-financing component compelled their later decision that validation did not apply. (*Davis II, supra*, 57 Cal.App.5th at p. 944.) *Davis I* has created significant anxiety and consternation, including legislative fixes to mitigate its more pernicious effects. (*Davis v. Fresno Unified School District* (2020) 57 Cal.App.5th 911, 942 fn. 17.) This Court’s clarification on whether the validation statutes apply to bond-funded lease-leaseback agreements is needed to restore confidence and limit costly litigation that drains the public fisc and delays vital infrastructure.

Honorable Chief Justice Tani Cantil-Sakauye
and Associate Justices
January 29, 2021
Page 6

CONCLUSION

This Court should grant review to resolve the split in authority between *Davis II* and *McGee II*, and to stabilize the law around public financing of construction projects. For the reasons stated above and in Fresno Unified School District's Petition for Review, Cal Cities respectfully urges this Court to grant review.

Respectfully,



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PROOF OF SERVICE
Davis v. Fresno Unified School District
Supreme Court Case No. S266344
Fifth District Court of Appeal Case No. F079811
Fresno County Superior Case No. 12CECG03718

I, the undersigned, declare:

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action. My business address is 790 E. Colorado Blvd., Suite 850, Pasadena, California 91101-2109.

On **January 29, 2021**, I served the document(s) described as: **AMICUS CURIAE LETTER OF THE LEAGUE OF CALIFORNIA CITIES IN SUPPORT OF PETITION FOR REVIEW** on the interested parties in this action as follows:

SEE ATTACHED SERVICE LIST

- BY ELECTRONIC FILING:** By transmitting via the electronic filing system, TrueFiling, the document(s) listed above to those identified on the service list attached.
- BY MAIL:** By placing the document(s) listed above in a sealed envelope with postage thereon fully prepaid, in the United States mail at Los Angeles, California addressed as identified on the service list attached.

I am readily familiar with the firm's practice of collection and processing correspondence for mailing. Under that practice it would be deposited with the U.S. 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 above is true and correct.

Executed on January 29, 2021, at Los Angeles, California.



SHOEBHA HASSAN

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Davis v. Fresno Unified School District
Supreme Court Case No. S266344
Fifth District Court of Appeal Case No. F079811
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