



Education Law Alert

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California 4th Appellate District Court Confirms that Competitive Bidding is Not Required for K-12 Lease-Leaseback Construction Procurements

The California Court of Appeal in *Los Alamitos Unified School District v. Howard Contracting, Inc.* (2014) recently ruled that Education Code Section 17406 exempts K-12 school districts from obtaining competitive bids in lease-leaseback agreements for school property improvements.

Historical Overview

Lease-leaseback contracts were sometimes referred to as design-build contracts prior to the enactment of various design-build enabling statutes. The two types of procurement are similar because like design-build, lease-leaseback projects provide for the design and construction of a project by a single entity.

The lease-leaseback procurement approach has become increasingly popular in recent years because it avoids competitive bidding and provides school districts with a guaranteed maximum price for completion of a project, thereby placing the risk of cost overruns with the contractor. The rationale for avoiding competitive bidding is that lease-leaseback agreements are intended to be a financing vehicle. The basic documents required for a lease-leaseback procurement are a resolution authorizing the contract, a site lease, a sublease agreement, and a lease-leaseback agreement.

Because the lease-leaseback approach avoids competitive bidding, it has been challenged in a variety of venues. In 2005, for example, the California Legislature passed AB 1097, requiring that competitive proposals be obtained in order for school districts to enter into lease-leaseback contracts. The bill was vetoed by the Governor, who stated that while

Attorney Spotlight



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he was generally supportive of using a competitive process for public works projects, "this bill imposes restrictions on lease-leaseback contracts that could limit competition, inadvertently limit flexibility for schools, and drive higher administrative costs, thereby potentially increasing the overall cost of building school facilities." Although some administrators take the position that the Governor's veto essentially validated lease-leaseback financings, many school districts obtain judicial validation of lease-leaseback agreements, pursuant to Code of Civil Procedure Section 860, to protect both the district and the contractor from subsequent challenge.

Factual Background

The Los Alamitos Unified School District entered into a lease-leaseback agreement for construction upgrades and improvements to the District's high school track and athletic field. The District filed a validation action pursuant to Code of Civil Procedure Section 860. Howard Contracting filed an Answer, claiming the lease-leaseback agreement was unconstitutional, illegal, and invalid because the District did not obtain competitive bids for the project.

Statutes at Issue

Education Code Section 17406(a) provides in pertinent part: "(a) 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" (emphasis added).

Education Code Section 17417 provides in pertinent part: "Of the proposals submitted which conform to all terms and conditions specified in the resolution of intention to enter a lease or agreement and which are made by responsible bidders, the proposal which calls for the lowest rental shall be finally accepted, or the board shall reject all bids" (emphasis added).

Thus, Section 17417 appears to require that lease agreements be awarded to the low bidder.

Non-Competitive Exclusion Applies to Entire Series of Lease-Leaseback Agreements

Howard Contracting relied on Education Code Section 17417 to challenge the District's failure to competitively bid the project under Education Code Section 17406, contending that the non-competitive exclusion only applied to the site lease, not to the sublease for the



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The Court of Appeal explained that Section 17406 sets the minimum annual rental fee the contractor is to pay the school district at \$1. The Court noted, "No one who actually wanted to win the project could ever be underbid in the site lease agreement," i.e., the \$1.

In addition, Howard Contracting argued that the more specific Section 17417 takes precedence over what it contended was the more general Section 17406. The Court rejected this argument, noting that the specific language of Section 17406 contains introductory language "notwithstanding Section 17417," which shows that Section 17406 provides an express exception to the more general 17417.

Howard Contracting also argued that if Section 17406 applies to the entire series of lease-leaseback agreements, then Section 17417 would be rendered a nullity. The Court rejected this argument by noting without specificity, that there were "many ways in which Section 17417 would be used, even if lease-leaseback arrangements are excluded from it."

Finally, the Court of Appeal also rejected a number of Howard Contracting's procedural arguments regarding the identity of the hearing judge, the service of summons, and the notice period. As to the notice period, the Court noted that because the District could have proceeded with the contract award with no validation action, it was not required to wait until the validation action was concluded to commence construction.

Impact

The Los Alamitos decision simply confirms the express language of Section 17406 empowering school districts to proceed with the lease-leaseback contracts without advertising for bids.

An issue that has not yet been addressed is whether lease-leaseback construction procurements for community college districts under Education Code Section 81335 are subject to competitive bidding. Notably, although Education Code Section 81335 for community colleges is similar to Education Code Section 17406, it significantly omits the language "without advertising for bids." Some commentators argue that the omission was simply that - an omission during the preparation of legislation and that the intent for the statute is the same as Section 17406. Nevertheless, the plain language of Education Code Section 81335, when compared to Education Code Section 17406, could provide a basis to require competitive bidding.

No court has yet squarely addressed this issue. Community college districts, in particular, are therefore well advised to use Code of Civil Procedure section 860 validation actions to obtain judicial confirmation of their lease-leaseback procurements.