

CLIENT NEWS BRIEF

Legislature Imposes New Procedures for Selection of Lease-Leaseback Contractors

Scrutiny regarding school districts' use of lease-leaseback (LLB) construction contracts has prompted the Legislature to impose additional contracting requirements that will make the use of LLB more complicated, and will limit a school district's discretion in selecting the LLB contractor. Assembly Bill (AB) 2316, which the Governor signed on September 23, 2016, will require school districts to use a comprehensive "best value" selection process for LLB contractors. AB 2316 also grants specific financial protection to contractors who were awarded LLB contracts prior to July 1, 2015. The bill goes into effect on January 1, 2017.

What is Lease-Leaseback?

Education Code section 17406 permits a school district to lease a site to a contractor for \$1 per year for the purpose of the contractor performing construction on that site. The contractor typically leases the site back to the school district in exchange for payments to compensate the contractor for the cost of construction. Until now, section 17406 has specifically permitted selection of the LLB contractor without advertising for bids and without requiring any selection process.

Recent History of Lease-Leaseback

The law related to LLB contracts has changed significantly over the last two years. Effective January 1, 2015, AB 1581 required prequalification for contractors on LLB projects that were over \$1 million, funded by the state and for districts with an average daily attendance (ADA) of 2,500 or more. (Ed. Code, § 17406; Pub. Contract Code, § 20111.6; [see 2014 Client News Brief No. 71](#).) Though not a model of clarity, effective January 1, 2016, AB 566 appears to have extended prequalification to all LLB projects for districts with ADA of 2,500 or more, regardless of funding source and regardless of price. AB 566 also required use of a "skilled and trained workforce." (See Ed. Code, §§ 17406, 17407.5; and [2015 Client News Brief No. 51](#).)

On June 1, 2015, an appellate court held that an LLB contract must contain provisions that reflect contractor financing and post-construction tenancy by the school district, and that an LLB contract with an entity that provided preconstruction services under a separate contract could be subject to legal challenge for a potential conflict of interest under Government Code section 1090. (*Davis v. Fresno Unified School District* (2015) 237 Cal.App.4th 261; [see 2015 Client News Brief No. 30](#).)

On April 12, 2016, an appellate court agreed with the *Davis* court about the potential for a conflict of interest in an LLB contractor's performance of preconstruction services under an earlier contract, but disagreed with the *Davis* court regarding terms required for LLB contracts, ruling that an LLB contract need not include provisions about contractor financing and post-construction tenancy. (*McGee v. Balfour Beatty Construction* (2016) 247 Cal.App.4th 235; [see 2016 Client News Brief No. 25](#).) A conflict therefore exists in California courts

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As the information contained herein is necessarily general, its application to a particular set of facts and circumstances may vary. For this reason, this News Brief does not constitute legal advice. We recommend that you consult with your counsel prior to acting on the information contained herein.

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as to what must be contained in an LLB contract.

New Procedures for Selection of Lease-Leaseback Contractor

Beginning on January 1, 2017, AB 2316 requires selection of the LLB contractor through a "best value" procedure specifically laid out in statute. Proposals submitted in response to a request for proposals (RFP) will be ranked by their best value scores and the Board must award to the contractor that submitted the sealed proposal determined by the Board to be the best value. In other words, aside from developing a scoring system for ranking the proposals, a school district will now have limited discretion in selecting its LLB contractor.

Beneficially, the bill expressly permits a school district to award a single LLB contract that includes preconstruction services, thus avoiding any potential conflict of interest issue under *Davis* and *McGee* resulting from the award of multiple contracts to the same contractor. AB 2316 also permits a school district to award the LLB contract for an agreed-upon lump sum or a fee for performing the services.

Protection for Pre-*Davis* Lease-Leaseback Contractors

Another significant aspect of AB 2316 is that it provides protection for contractors that entered into an LLB contract prior to July 1, 2015. For these contracts, if a court declares the contract award invalid due to a lack of competitive bidding, the contractor would be allowed to recover its reasonable costs incurred in performing the project, but not its profit. To recover such costs, the contractor must meet several requirements, such as establishing that it had a good faith belief that the LLB contract was valid.

Effect of AB 2316 on Recent Lease-Leaseback Law

The bill does not change existing statutory requirements that contractors be prequalified prior to award of an LLB contract and that they use a skilled and trained workforce. In addition, AB 2316 does not provide any guidance on what lease and payment terms are required in the LLB contract, and does not eliminate the risk of a conflict of interest caused by multiple contracts with the same contractor. (See *Davis* and *McGee*, above.)

Given the new requirements and the remaining unresolved legal issues concerning LLB, school districts considering this delivery method should consult closely with their legal counsel to evaluate the use of LLB as an alternative delivery method for construction projects.

If you have any questions about the new LLB contractor selection procedures or the legality of LLB contracts under the *Davis* and *McGee* cases, or about public works issues in general, please contact the authors of this Client News Brief or an attorney at one of our [10 offices](#) located statewide. You can also visit our [website](#), follow us on [Facebook](#) or [Twitter](#) or download our [Client News Brief App](#).