



# **The Pros & Cons of School Construction Delivery Methods**

**California League of  
Bond Oversight Committees**

**May 10, 2013**

**Kevin R. Carlin, Esq.**

**CARLIN LAW GROUP, APC (619)615-5325**

# School Districts Have Limited Powers

- A public school district is a public entity with limited powers.
  - “A board of school trustees is an administrative agency created by statute and invested only with the powers expressly conferred by the Legislature and cannot exceed the powers granted to them.” *Paterson v. Board of Trustees*, 157 Cal.App.2d 811, 818.
  - “Where the statute prescribes the only mode by which the power to contract shall be exercised the mode is the measure of the power.” *Reams v. Cooley*, 171 Cal. 150, 154.



# Contracts Not Made in Strict Conformity with Statutory Requirements are Void & Unenforceable

- “Where the statute prescribes the only mode by which the power to contract shall be exercised the mode is the measure of the power. A contract made otherwise than as so prescribed is not binding or obligatory as a contract and the doctrine of implied liability has no application in such cases.” *Merco Constr. Engineers, Inc. v. Los Angeles Unified School Dist.*, 274 Cal.App.2d 154, 160.

# Public Contract Code § 100

## **Purpose of Public Contract Code:**

- A. To clarify the law with respect to competitive bidding requirements.
- B. To ensure full compliance with competitive bidding statutes as a means of protecting the public from misuse of public funds.
- C. To provide all qualified bidders with a fair opportunity to enter the bidding process, thereby stimulating competition in a manner conducive to sound fiscal practices.
- D. To eliminate favoritism, fraud, and corruption in the awarding of public contracts.



# Traditional Design Bid Build

## **PUBLIC CONTRACT CODE § 20111(b)**

The governing board shall let any contract for a public project, as defined in subdivision (c) of Section 22002, involving an expenditure of fifteen thousand dollars (\$15,000) or more, to the lowest responsible bidder who shall give security as the board requires, or else reject all bids. All bids for construction work shall be presented under sealed cover...

# Traditional Design Bid Build

## **PUBLIC CONTRACT CODE § 20112 Invitation for Bids**

For the purpose of securing bids the governing board of a school district shall publish at least once a week for two weeks in some newspaper of general circulation published in the district, or if there is no such paper, then in some newspaper of general circulation, circulated in the county...

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# Design Build

Prior to the authorization of "design-build" contracting for school facilities, school districts awarded construction contracts to the lowest responsible bidder and contracted for architectural services on the basis of demonstrated competence and professional qualifications to be performed at a fair and reasonable price (not necessarily lowest bidder). Those laws meant that schools were built using a "design-bid-build" methodology wherein a separate contract was awarded for the design work by an architect and another contract was awarded to the lowest responsible bidder for the construction.

# Design Build

Education Code § 17250.20 authorizes school district governing boards to enter into a design-build contract with a single entity for the design and construction of a school facility for projects in excess of \$2,500,000 if, after evaluating traditional design-bid-build and design build processes in a public meeting, the governing board makes written findings that use of the design-build process on a specific project will either:

1. Reduce comparable project costs.
2. Expedite the project's completion.
3. Provide features not achievable through the traditional design-bid-build method.



# Design Build

Education Code §17250.25(a)(1) The school district governing board shall prepare a request for proposal setting forth the scope of the project that may include, but is not limited to, the size, type, and desired design character of the buildings and site, performance specifications covering the quality of materials, equipment, and workmanship, preliminary plans or building layouts, or any other information deemed necessary to describe adequately the school district's needs. The performance specifications and any plans shall be prepared by a design professional duly licensed or registered in this state. The request for proposal shall not include a design-build-operate contract for educational facilities pursuant to this chapter.

# Design Build

Education Code §17250.25(c) The school district shall establish a procedure for final selection of the design-build entity. Selection shall be based on either of the following criteria:

- (1) A competitive bidding process resulting in lump-sum bids by the prequalified design-build entities. Award shall be made on the basis of the lowest responsible bid.
- (2) Notwithstanding any other provision of this code or of Section 20110 of the Public Contract Code, a school district may use a design-build competition based upon performance and other criteria set forth by the governing board of the school district in the solicitation of proposals. Criteria used in this evaluation of proposals may include, but need not be limited to, the proposed design approach, life cycle costs, project features, and project functions. ...



# Summary of Lease-Leaseback Contracting Process

- The lease-leaseback method of contracting requires two contracts between a school district and a contractor.
- The first contract is a site lease agreement whereby the district leases to the contractor a site owned by the district to give the contractor the legal right to occupy and perform construction work on the district's property.
- Under the site lease agreement the contractor pays a nominal fee to the district, usually a dollar a year, to gain title and access to the property upon which the project will be constructed.
- The second contract is a sublease agreement whereby the school district leases back from the contractor the project site by making periodic payments up to the agreed upon cost of construction.
- It is through the sublease agreement that the school district pays the contractor the cost of construction.

# SCHOOL DISTRICT LEASE-LEASEBACK CONTRACTING

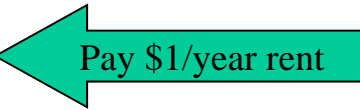
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## 1. Site Lease

District  
(Landlord)



Pay \$1/year rent



*Education Code 17406*

Right to Occupy Project



Contractor  
(Tenant)

- No competitive bidding required because Contractor pays District

## 2. Sublease

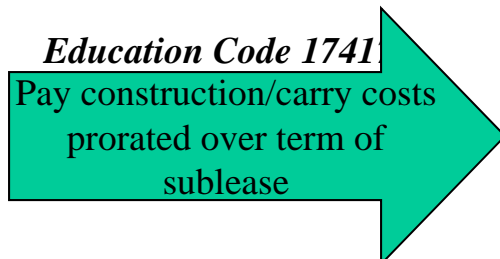
District  
(Tenant)

Right to Occupy Project



*Education Code 1741*

Pay construction/carry costs  
prorated over term of  
sublease



Contractor  
(Landlord)



- Competitive bidding required because District pays Contractor.

- Competitive bidding ensures District gets best deal and pays least amount.



# Lease-Leaseback

## **Education Code § 17406**

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.

# Lease-Leaseback

- That Education Code § 17406 only applies to the site lease agreement is supported by the fact Education Code § 17406 uses the term “let” which is a verb. According to the New Webster’s Dictionary of the English Language the word “let” means “To permit; to allow; to permit to enter, pass or go; to rent or lease...”
- Further, <http://www.thefreedictionary.com/let> defines "let" as follows:
  - To rent or lease: let rooms.
  - To award, especially after bids have been submitted: let the construction job to a new firm.
  - To become rented or leased.
  - To be or become assigned, as to a contractor.
- Finally, <http://www.merriam-webster.com/dictionary/let> defines "let" as follows:
  - To offer or grant for rent or lease (i.e. let rooms)
  - To assign especially after bids (i.e. let a contract)



# Lease-Leaseback

- **Requirements of Education Code §17417:**

A. In a regular open meeting, adopt a resolution declaring its intention to enter into a lease or agreement pursuant to Article 2 of Chapter 4 of Part 10.5 of Division 1 of the Education Code (consisting of section 17400 to 17229).

B. Adopt a resolution stating the minimum yearly rental at which the governing board will lease real property belonging to the district upon which the building is to be constructed.

C. Adopt a resolution stating the maximum number of years for which the school district will lease the project back.

D. Adopt a resolution stating that the proposals submitted therefore shall designate the amount of rental, which shall be annual, semiannual, or monthly, to be paid by the district to lease the project back.

# Lease-Leaseback

- **Requirements of Education Code §17417 (cont.):**

E. Adopt a resolution fixing a time, not less than three weeks thereafter for a public meeting of the governing board to be held at its regular place of meeting, at which sealed proposals to enter a lease or agreement with the school district will be received from any person, firm, or corporation, and considered by the governing board.

F. Give notice in the manner provided in Education Code Section 17469 that a public meeting of the governing board would be held at its regular place of meeting, at which time sealed proposals to enter a lease or agreement with the district would be received.

G. At the time and place fixed in the resolution for the meeting of the governing body, in public session, open, examine and have declared by the board all sealed proposals which have been received by district.

H. From 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, accept only the proposal which calls for the lowest rental to be paid by the district to lease the project back from the person to whom the site would be leased.



# Lease – Leaseback Contracting

Proponents of Leasebacks assert current law authorizes a school district to lease any real property (without advertising for bids) to any person, firm, or corporation so long as the lease agreement provides for the construction of a building or buildings for the use of the district during the term of the lease, and provides that title to the building belongs to the school district at the expiration of the lease term.

# **Proliferation of Illegal Lease Leaseback School Contracting**

- As a result of their financial, marketing and political efforts, a small group of consultants and general contractors are profiting tremendously from the lack of full and fair competition associated with lease-leaseback contracting by California school districts.
- Lease-leaseback is overtaking traditional competitive bidding as the primary contracting method for public school construction in California.
- This is effectively shutting out the vast majority of general contractors and subcontractors that would ordinarily bid on school work in the open market and driving up construction costs for school districts due to reduced competition.
- More than 30 of the 42 school districts in San Diego County are reported to be using lease-leaseback.
- Statewide the proportion appears to be similar as more and more school district governing boards and administrations abdicate their fiduciary obligation to fairly, wisely and prudently spend their taxpayers' dollars.

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*Via Hand Delivery @ Meeting*

January 25, 2013

Issues Committee  
San Diego County Taxpayers Association  
c/o Mr. Chris Cate  
707 Broadway  
San Diego, CA 92101

**Capital Appreciation Bonds Used to Pay for Non-Competitively Bid School Construction:  
Taxpayers Get Fleeced on Both Ends!**

Dear Fellow Issues Committee Members:

Thank you for taking an interest and active role in the recently proposed legislation to remedy the harm being caused to California taxpayers by school districts use of capital appreciation bonds (“CAB’s”). CAB’s are only one side of the coin that is presently harming California’s taxpayers. The other side of the coin is school districts use of lease-leaseback contracting under Education Code §17400, et seq., as a subterfuge to avoid real competitive bidding instead of the long term school facility financing mechanism it has always been intended to be. Attached herewith as **Exhibit A** is an excerpt of the San Diego County School Districts referenced in the Los Angeles Times November 28, 2012 article and spreadsheet discussing the widespread use and abuse of capital appreciation bonds. Exhibit A shows that 12 out of 15 San Diego county K-12 school districts that used capital appreciation bonds also spent those bond proceeds on construction projects awarded via lease leaseback contracts without real competitive bidding. Also attached hereto as **Exhibit B** for your reference is a 2004 article from the State Allocation Board outlining the way non-competitively bid lease-leaseback school construction is currently being administered to the detriment of California’s taxpayers (see especially pages 5 and 6).

An objective and critical analysis of CAB’s and lease-leaseback contracting by the school districts results in a conclusion that California’s taxpayers are being taken advantage of on both ends of the spectrum. On the front end with the use of CAB’s and other imprudent financing methods such as Bond Anticipation Notes (“BAN’s”) the taxpayers are being charged far more than the typical \$3 or \$4 to \$1 financing costs traditionally associated with general obligation bond financing. Instead, as in the case of Poway the repayment rates are nearly \$10 per every \$1 borrowed. Thus on the front end, taxpayers are paying too much to borrow the monies that are being used to fund school construction. On the back end, taxpayers are being taken advantage of and harmed by paying more than is necessary for school construction due to the school districts’ use of lease-leaseback contracting without real competitive bidding.

**Exhibit A**

**Carlin Law Group, APC**

Issues Committee

San Diego County Taxpayers Association

January 23, 2013

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The other flaw with lease-leaseback as currently used is that the leaseback term is equivalent to the duration of construction with interim progress payments being made based on a percent complete basis rather than as a true reflection of rental payments. Under lease-leaseback legislation originally enacted in the 1950s the school district was to specify a longer term of years (i.e. 15, 20, 25 or 30 years) by which all bidders were to base their proposals for construction and financing of the specified project. Under the foregoing scenario, the bidders truly were financing the costs of construction for the school districts because they were required to pay for the initial construction out of their own pockets and then seek reimbursement of same, plus a carrying cost over time according to the longevity of the term of the leaseback agreement. This is not occurring under the current lease-leaseback arrangements. Instead, the school districts have (on account of Capital Appreciation Bonds) all of the monies necessary to immediately pay for the construction of the proposed school facility. Thus, there is no financing component in the lease-leaseback transaction. What is more, there is no assurance that the school district is getting the best price for the proposed school facility as designed and approved by the Division of State Architect because the contractor proposals upon which the lease-leaseback contracts are awarded are received prior to the final design and approval from DSA.

Current lease-leaseback contractors (including those on SDCTA Board of Directors) will attempt to defend the value and benefit of their lucrative arrangements with their respective school districts by asserting that they competitively bid all of the trade contracts associated with the construction of the proposed school facility. Because of the way in which lease-leaseback trade contract bidding is administered it is questionable whether this obtains the true best cost for the school district. Additionally, the overhead and contingency costs paid directly to the leaseback contractors are not competitively bid and therefore there is no way to assure that the school district is getting the best value and price on this significant aspect of the cost of construction.

If lease-leaseback contracts were bid in strict compliance with Education Code §17417, there would be absolute assurance that the school districts (and therefore the taxpayers) were getting the best value and price for the proposed school facility. The legislative solution to the foregoing problem would be to amend the current lease-leaseback legislation at Education Code §17400 to contain language which expressly states that Education Code §17406's exemption from competitive bidding only applies to the site lease agreement by which the district leases its property to the leaseback contractor and that the competitive bidding requirements of Education Code §17417 apply to the sublease agreement whereby the school district pays money to the leaseback contractor to cover its costs of construction and finance carrying costs. Attached herewith as **Exhibit C** is a demonstrative exhibit which illustrates this arrangement.

Unfortunately, school districts and lease-leaseback contractors are taking advantage of an ambiguity in Education Code §17406 to assert that it does not require competitive bidding of the leaseback contract whereby the school district is paying money to the leaseback contractor. This office is presently engaged in litigation challenging this improper interpretation of Education Code §17406 but is finding that courts are giving great deference the interpretation asserted by school districts and their contractors that said section does not require competitive bidding. Accordingly, a legislative clarification of this incorrect interpretation would be helpful to avoid continuation of



**Carlin Law Group, APC**

Issues Committee

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this improper and imprudent practice.

If you have any questions or concerns relative to the foregoing, please do not hesitate to contact me.

Sincerely,

CARLIN LAW GROUP, A.P.C.

A handwritten signature in black ink, appearing to read 'K R Carlin', with a long horizontal flourish extending to the right.

Kevin R. Carlin

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**Exhibit A**

Exhibit A



## San Diego County School Districts with Capital Appreciation Bonds

<u>Lease Leaseback</u>	<u>District</u>	<u>Sale year</u>	<u>Principal</u>	<u>Total debt service</u>	<u>Maturity length</u>	<u>Maturity warning</u>	<u>Debt ratio</u>	<u>Ratio warning</u>
Yes	Bonsall Union School District	2007	\$2,618,308.75	\$11,645,000.00	32.02	Y	4.45	Y
Yes	Bonsall Union School District	2007	\$2,866,127.70	\$6,740,000.00	25.02	Y	2.35	N
Yes	Cajon Valley Union School District	2012	\$7,999,932.35	\$15,750,000.00	17.98	N	1.97	N
Yes	Carlsbad Unified School District	2011	\$3,255,389.45	\$3,605,000.00	2.15	N	1.11	N
Yes	Carlsbad Unified School District	2009	\$21,399,566.85	\$28,745,000.00	9.97	N	1.34	N
???	Dehesa School District	2012	\$84,851.70	\$500,151.20	23.05	N	5.89	Y
Yes	Encinitas Union School District	2011	\$2,993,462.90	\$6,990,000.00	15.21	N	2.34	N
Yes	Escondido Union High School District	2011	\$17,588,806.10	\$157,302,720.70	39.82	Y	8.94	Y
Yes	Escondido Union High School District	2009	\$26,996,392.00	\$246,634,638.10	39.67	Y	9.14	Y
Yes	Escondido Union High School District	2009	\$30,749,550.70	\$109,490,000.00	24.95	N	3.56	N
Yes	Grossmont Union High School District	2008	\$27,429,577.80	\$90,120,000.00	25.03	Y	3.29	N
???	Grossmont-Cuyamaca Community College District	2008	\$52,000,376.60	\$154,840,000.00	23.21	N	2.98	N
???	Grossmont-Cuyamaca Community College District	2008	\$7,650,749.05	\$17,595,000.00	8.21	N	2.30	N
???	Lemon Grove School District	2010	\$3,131,654.90	\$28,276,166.85	39.85	Y	9.03	Y
Yes	Oceanside Unified School District	2012	\$14,998,070.90	\$108,471,672.60	39.30	Y	7.23	Y
Yes	Oceanside Unified School District	2010	\$29,999,991.00	\$279,650,996.40	39.24	Y	9.32	Y
Yes	Oceanside Unified School District	2009	\$25,095,053.70	\$76,290,000.00	22.44	N	3.04	N
???	Palomar Community College District	2010	\$27,883,490.50	\$85,770,000.00	24.76	N	3.08	N
Yes	Poway Unified School District	2011	\$105,000,149.70	\$981,562,328.20	39.99	Y	9.35	Y
Yes	Poway Unified School District	2010	\$24,998,007.00	\$26,270,000.00	1.73	N	1.05	N
Yes	Poway Unified School District	2009	\$3,698,553.90	\$5,130,000.00	7.56	N	1.39	N
Yes	Poway Unified School District	2009	\$73,998,935.75	\$260,725,000.00	24.56	N	3.52	N
Yes	Poway Unified School District	2007	\$7,689,087.48	\$16,895,139.59	33.26	Y	2.20	N

## San Diego County School Districts with Capital Appreciation Bonds

<u>Lease Leaseback</u>	<u>District</u>	<u>Sale year</u>	<u>Principal</u>	<u>Total debt service</u>	<u>Maturity length</u>	<u>Maturity warning</u>	<u>Debt ratio</u>	<u>Ratio warning</u>
Yes	Poway Unified School District	2007	\$1,598,847.12	\$4,861,619.32	25.26	Y	3.04	N
Yes	Poway Unified School District Public Financing Authority	2007	\$34,783,991.00	\$38,900,000.00	32.31	Y	1.12	N
Yes	Rancho Santa Fe School District	2008	\$1,034,042.30	\$2,840,000.00	23.03	N	2.75	N
Yes	Rancho Santa Fe School District	2008	\$3,402,570.70	\$5,345,000.00	10.03	N	1.57	N
???	San Diego Community College District	2011	\$16,449,858.60	\$91,955,000.00	30.07	Y	5.59	Y
???	San Diego Community College District	2007	\$20,191,823.10	\$27,885,000.00	10.04	N	1.38	N
???	San Diego Unified School District	2012	\$58,612,560.95	\$338,741,690.10	39.14	Y	5.78	Y
???	San Diego Unified School District	2012	\$65,434,441.70	\$164,690,000.00	19.33	N	2.52	N
???	San Diego Unified School District	2010	\$88,870,484.75	\$630,400,000.00	36.90	Y	7.09	Y
???	San Diego Unified School District	2009	\$57,988,743.55	\$166,995,000.00	22.19	N	2.88	N
Yes	San Marcos School Financing Authority	2010	\$2,483,327.30	\$10,870,000.00	24.20	N	4.38	Y
Yes	San Marcos Unified School District	2012	\$64,995,522.20	\$403,040,633.80	39.27	Y	6.20	Y
Yes	San Marcos Unified School District	2011	\$25,346,475.70	\$58,170,000.00	21.11	N	2.29	N
Yes	San Ysidro School District	2011	\$15,599,622.90	\$228,945,000.00	39.13	Y	14.68	Y
Yes	San Ysidro School District	2007	\$14,137,740.90	\$44,880,000.00	24.71	N	3.17	N
Yes	Santee School District	2011	\$3,534,306.75	\$58,559,818.15	39.97	Y	16.57	Y
Yes	Santee School District	2008	\$879,849.45	\$2,760,000.00	23.02	N	3.14	N
Yes	Santee School District	2008	\$2,869,039.35	\$7,370,000.00	24.95	N	2.57	N
Yes	Santee School District	2008	\$7,840,155.20	\$55,232,154.70	39.95	Y	7.04	Y
Yes	Santee School District	2008	\$1,145,076.75	\$2,065,000.00	10.95	N	1.80	N
???	Southwestern Community College District	2011	\$10,375,371.35	\$116,050,002.00	35.16	Y	11.19	Y

Exhibit A



# **Exhibit B**

Exhibit A

REPORT OF THE EXECUTIVE OFFICER  
State Allocation Board Meeting, January 28, 2004

LEASE LEASE-BACK AGREEMENTS (EDUCATION CODE SECTION 17406)

PURPOSE OF REPORT

To discuss the use of lease lease-back agreements for project delivery of facilities funded through the School Facility Program (SFP).

SUMMARY

The use of Education Code (EC) Section 17406 as a project delivery method for public school construction projects is growing. Increasingly, districts are interpreting this code section to allow the award of a public works project without competitive bid. Some districts do institute a competitive selection process voluntarily, but many do not. Districts maintain that this alternative is often superior to the standard low-bid procedure generally required by the Public Contracts Code (PCC).

The contractual arrangements by which projects are constructed using state bond funding is governed by law and is not generally subject to State Allocation Board (SAB) regulation or oversight. However, the integrity of the use of general obligation bonds allocated by the SAB must be above reproach. An interpretation of law that would potentially allow billions of dollars of public works projects funded with state bonds to be contracted through a 'sole-source' mechanism should be closely examined. That is the primary purpose of this report.

BACKGROUND

EC Sections 17400 through 17425 provide a method for financing school construction. Within that financing method, EC Section 17406 provides a mechanism whereby a district may let district real property to a development entity without competitive bidding if the developer will construct a school facility on the property for the use of the school district. An increasing number of districts are using this approach to construct new facilities and modernize existing facilities without competitive bid. Generally, the districts then request State funding for the purpose of buying out the lease and acquiring the facility.

To date, neither the SAB nor Office of Public School Construction (OPSC) has taken a position on when the use of lease arrangements under EC Section 17406 is appropriate or when the exemption from competitive bidding is valid. The OPSC has not dictated the method of the delivery of projects and has taken the position that the obligation to determine the appropriate and legitimate use of any contract delivery method permitted in law rests with the school district. The OPSC has focused instead on providing guidance to those districts that elect to use lease-lease back agreements to insure that there is no conflict with SFP law and regulations or with statutes relating to the use of the state general obligation bonds.

DESCRIPTION

Over a period of several years, the OPSC responded to a few individual school district questions on issues related to the use of EC 17406. These responses guided districts on how to structure their agreements to avoid conflicts with SFP laws and regulations. The responses were widely disseminated among school districts and their legal advisors as the OPSC "policy" on lease lease-back project delivery methods. As a result of a rapidly

(Continued on Page Two)

**Exhibit A**

DESCRIPTION (cont.)

increasing number of inquires regarding EC Section 17406, the OPSC became aware that the use of lease lease-back agreements was growing. For the first time, the OPSC also became aware that such agreements were now in common use on modernization projects, something that had never been previously discussed with the office. Although staff continued to take the position that it was the district's responsibility to determine when it was appropriate and legal to use EC Section 17406 as a project delivery method, staff also became concerned that there was no official SAB position or regulation on any aspect of the issue. To address that, staff began discussions on the use of EC Section 17406 at the Board's Implementation Committee. The discussions were designed as a fact-finding effort to learn about the use of lease lease-back agreements and to develop regulations to solidify the policy statements made over several years of correspondence.

Following four separate Implementation Committee meetings, the OPSC presented proposed changes to the SAB's regulations concerning the interface of lease lease-back agreements and the SFP. Again, the regulations focused on largely technical issues and not on when the use of EC 17406 was appropriate. However, the presentation, made in September 2003, did include a report to the SAB regarding the use of lease lease-back agreements as a delivery method for projects funded under the SFP. It was apparent that this delivery method was being used or considered by a significant number of districts. The OPSC wished to inform the SAB that information about project delivery methods is not requested prior to approval, and, therefore, it was possible that projects using the lease lease-back method were being presented for funding on consent calendars.

When the item was presented to the SAB, some members expressed concerns about the effect that widespread use of EC Section 17406 might have on the PCC competitive bidding requirements. The SAB declined to take action on the recommended regulation changes and asked that staff prepare further information, including the number of projects using the lease lease-back method, for consideration at a future meeting.

Three subsequent discussions were held at the Implementation Committee. The content of this report was presented and discussed. There was no consensus among the Committee members regarding the content or conclusions of this report or what actions the SAB should take, if any.

THE CURRENT USE OF EC SECTION 17406

In broad terms there are currently two types of lease lease-back arrangements being used to construct state funded projects:

1. The project is financed by the developer/contractor team and the district pays a yearly lease to use the facility. The district makes no other payments to the developer, who carries the outstanding cost of the project. The lease, by law, may be up to 40 years in length. It may include an agreement to terminate the lease at any time.
2. The project is paid in full by the district with state or local funds, or a combination of both. In this case a "lease agreement" may exist, but it is designed to be terminated at the end of the construction. The lease payments, if any, are made during the course of construction and at the completion of the project. They are essentially progress payments as would be found on a traditional construction contract in that they constitute the entire cost of the construction project.

(Continued on Page Three)



#### THE CURRENT USE OF EC SECTION 17406 (cont.)

Staff believes that agreements structured as in situation number one when competitively bid, constitute the intended use of Article 2 and of EC 17406 in particular.

However, staff believes that the vast majority of projects, which received or will receive SFP funding, were done under the second scenario. These projects are not financed by the developer/contractor team even for a short period. The projects are paid in full by the district using State and local funds. Since there is no legitimate lease, staff does not believe that Article 2 has any relevance. Please see further discussion in this report.

#### THE GROWING USE OF LEASE LEASE-BACK AGREEMENTS

As mentioned in the Description section of this report, the SAB asked Staff to quantify the number of projects which have used lease lease-back agreements as a delivery method. Staff has not been able to accomplish this request since the information is not reported to OPSC as a part of the application or funding process. Although it may be a matter of discussion in the closeout audit of an individual project, it is not captured and recorded in a way that would allow a count of the projects. For future reference, the Board may wish to capture this information by modifying the fund release certification received from applicant districts.

The San Diego County Office of Education did survey districts within that county, and as a courtesy, provided Staff with the results. They found that in the last six years, 35 to 40 projects were done with lease lease-back. The County estimates that approximately 25 percent were modernization projects. The County comprises about 10 percent of the K-12 population.

#### ARGUMENTS IN FAVOR OF THE LEASE LEASE-BACK DELIVERY METHOD

School districts which have used the lease lease-back project delivery method cite the following as reasons for selecting it over the traditional design, bid, and build approach:

- ❑ **Guaranteed price**  
The district is able to negotiate a fixed price for the lease and, if necessary, the purchase price of the project. Unanticipated costs are the responsibility of the developer/contractor, not the school district.
- ❑ **Team approach**  
Districts have expressed the opinion that lease lease-back allows a team approach to the construction of school facilities. The district, developer and contractor all have an interest in a project completed on time and in budget.
- ❑ **Known contractor**  
Contractors can be selected on the basis of their record of success, recommendations from previous clients and financial strength.
- ❑ **No experienced staff at district**  
Many districts do not have experience with large construction projects. The responsibility for coordination of the project, obtaining required approvals, and project scheduling become the developer/contractors, who have demonstrated experience in similar school construction projects.
- ❑ **Value engineering opportunities**

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ARGUMENTS IN FAVOR OF THE LEASE LEASE-BACK DELIVERY METHOD (cont.)

- Contractors and subcontractors come from other industries  
Contractors not normally interested in participating in the 'low bid' process may be willing to participate in negotiated contracts as permitted in the lease lease-back process. This brings new and highly qualified contractors into the school construction arena.

All of the benefits ascribed to the lease lease-back process are contingent on one thing -- avoiding competitive bidding. Many, perhaps most, school district administrators and facility managers consider the competitive bidding process as required under the PCC to be problematic. They assert that the process leaves them with little control over the selection of the contractor for the project and places them in financial jeopardy if the contractor selected is unwilling or unable to perform the construction as planned. The lease lease-back process allows the district to select the developer/contractor based on criteria other than cost.

CONCERNS ABOUT THE USE OF THE LEASE LEASE-BACK DELIVERY METHOD

While advocates of the use of EC Section 17406 argue that it is less cumbersome than the competitive bidding process and that it allows a team approach to the development of the project, it is important to keep in mind the reasons that competitive bid requirements were added to the PCC. The intent was not to make it harder to complete public works projects, but to ensure that State funds were being used in an efficient and cost-effective manner. The goal of the Legislature in enacting the code was<sup>1</sup>:

1. To ensure full compliance with competitive bidding statutes as a means of protecting the public from misuse of public funds, and;
2. To provide all qualified bidders with a fair opportunity to enter the bidding process, thereby stimulating competition in a manner conducive to sound fiscal practices, and;
3. To eliminate favoritism, fraud, and corruption in the awarding of public contracts.

The interpretation and growing use of EC Section 17406 means that significant numbers of projects and significant sums of public funding are not being subjected to the checks and balances of the competitive bid process. Recent interpretations made by some interested in furthering the use of EC Section 17406 are so broad as to make the public contract competitive bid requirements moot, effectively eliminating competitive bidding requirements on all new construction and modernization public school projects whether funded locally or in conjunction with the State program.

In addition to the lack of checks and balances on the selection of contractors, there may be other reasons to proceed cautiously when using lease lease-back arrangements which do not provide a long term financing mechanism for the project. Primary among these is summarized in the Supreme Court majority opinion in *The City of Los Angeles v. Offner* where the following was stated:

*"It has been held generally in the numerous cases that have come before this court involving leases and agreements containing options to purchase that if the lease or other agreement is entered into in good faith and creates no immediate indebtedness for the aggregate installments therein provided for but, on the contrary,*

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<sup>1</sup> Public Contracts Code, Section 100

CONCERNS ABOUT THE USE OF THE LEASE LEASE-BACK DELIVERY METHOD (cont.)

*confines liability to each installment as it falls due and each year's payment is for the consideration actually furnished that year, no violence is done to the constitutional provision. If, however, the instrument creates a full and complete liability upon its execution, or if its designation as a 'lease' is a subterfuge and is actually a sales contract in which the 'rentals' are installment payments on the purchase price for the aggregate of which and immediate and present indebtedness or liability exceeding the constitutional limitation arises against the public entity, the contract is void.*" (underlining added)

It appears to the OSPC that some of the following circumstances do not exist in all lease lease-back contracts presented for SFP funding and therefore may be in violation of the principle set forth in Offner.

- The lease must be entered into in 'good faith.' Presumably that means that both parties to the agreement intend that a lease arrangement will exist and will be implemented.
- The lease arrangement may not be a subterfuge. Many districts openly admit that they are using lease lease-back contracts for the perceived benefits listed earlier which are only available if there is no competitive bid requirement.
- The agreement may not create an immediate indebtedness beyond each yearly installment. Some agreements require 'pre-lease' or 'rental' in one form or another which amount to the full cost of the facility. It appears that an immediate indebtedness has been created by the agreement.
- The District must own the site on which the project will be constructed. Under EC 17402, the district owns the site if it holds title, has an option to purchase, or is acquiring the site through eminent domain. An arrangement whereby the option to purchase the site is with the developing entity could be construed as a subterfuge to avoid EC 17407. That section allows lease lease-back on property owned by others, but specifically requires competitive bidding of the agreement.

It is possible then that the school construction contract, using a lease agreement that does not meet the standard of the Offner decision, may be invalid, raising the question of the appropriateness of the State funding apportionment.

THE PURPOSE OF EC SECTION 17406

Education Code Section 17406 reads in part as follows:

*17406. (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. 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.*  
(The entire section may be seen in the Attachment.)

Advocates of the use of lease lease-back agreements argue that the only requirement in EC Section 17406 is that the district owns the property to be developed and that the property be 'let' to the developer for at least one

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THE PURPOSE OF EC SECTION 174 06 (cont.)

dollar per year. Under this circumstance the district is then relieved from the normal PCC competitive bid requirement for the entire construction project. At this point some advocates maintain that a lease lease-back arrangement is required for the actual buildings, while others believe a simple construction contract is all that is required.

It is the opinion of staff and SAB counsel that either interpretation expands the meaning of EC 17406 beyond its simple intent and ignores other requirements in the same article regarding competitive bid requirements for leases (EC 17417). There is no disagreement that EC 17406 is clear in allowing districts to lease a district- owned site to a person, firm or corporation when the lessee agrees to construct buildings for the use of the school district. However, the exemption from public bidding allowed in this section applies only to the property lease from the district to the developer. It does not address how the contract for the construction of the buildings is procured nor does it provide an exemption to competitive bidding for that contract.

If the building to be constructed on the property let to the developer using EC 17406 is to be leased to the district, Staff believes the provisions of EC 17417 *Resolution of governing board declaring intention to enter into lease or agreement; opening and accepting bids*, must be followed. That section specifies that the governing board of a school district ...

*"...shall adopt a resolution declaring its intention to enter into a lease or agreement pursuant to this article...The resolution shall fix a time ... at which sealed proposals to enter a lease or agreement with the school district will be received from any person, firm, or corporation, and considered by the governing board...At the time and place fixed in the resolution for the meeting of the governing body, all sealed proposals which have been received shall, in public session, be opened, examined, and declared by the board. 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." (underline added.) (The entire section may be found in the Attachment.)*

Nothing in EC 17406 provides an exemption from this requirement or, when applicable, from the PCC requirements. Instead, EC 17406 provides exactly what it states: a simple manner to transfer district property without competitive bid to a developer who has been previously selected by competitive bid to construct a building for the use of the district.

USING EC SECTION 17400 ET AL. AS A FINANCING MECHANISM

EC Sections 17400 et al., including EC 17406, make up Article 2 of Chapter 4 of Part 10.5 of the EC, 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 USD v. Amaroso, 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 EC Sections 39300 through 39325, which are now renumbered as 17400 through 17425. Thus EC 17400 through 17425 is a method of financing school construction in which EC 17406 addresses the mechanism by which the school district can let the property where the construction will take place.

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USING EC SECTION 17400 ET AL. AS A FINANCING MECHANISM (cont.)

Staff believes that virtually none of the projects currently using lease lease-back 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 the 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 agreement (or there is no lease agreement at all), the use of Article 2 appears to be inappropriate.

COMPETITIVE SELECTION PROCESSES

As noted elsewhere in this Report, current interpretations of EC 17406 hold that competitive bidding is not required. However, some districts do use a competitive selection process. Although not a 'low bid' selection, the competitive mechanism may include open participation and consideration of cost among other factors.

There are several reasons to have a selection process, even when the district believes that it is not specifically required.

- Helps ensure a competitive cost for the project.
- Allows the district to select the most qualified firm to design and construct the project, based on experience, financial capability, and other factors.
- Provides a public process open to review.
- Allows open participation.

While Staff believes that a low bid requirement already exists for leases, it is clear that school districts do not agree in every case. The legislature may wish to consider the option of requiring a competitive selection process rather than a competitive bid process. To that end, selection processes already in use by the Los Angeles Unified School District, the Building Industry Association, and recommendations developed by Best, Best and Krieger, LLP for the use of their clients have been submitted to the OPSC and are available to the Board as examples. None of the processes have been reviewed by the OPSC.

Additionally, legislation governing the use of design build processes (EC Section 17250.25(c)) provides two options for selection of the design/build team: lowest responsible bid or 'best value' selection of prequalified candidates based on a weighted scoring method. The best value method gives the school district flexibility in awarding a project based on factors other than price. The required selection criteria are price, technical expertise, life cycle costs, skilled labor force, and safety record. In addition, the district may consider design approach, project approach, project features, schedule, value engineering and warranty. This process can be time-consuming and, in the opinion of some, is fraught with protest opportunities; however, it does provide an open process which assists the district in finding a qualified construction team at a competitive price while also keeping public safeguards in place.

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### LEASE LEASE-BACK ARRANGEMENTS IN SFP PROJECTS

Regardless of debates about the appropriate use of EC Section 17406 or about whether competitive selection processes should be used, districts are currently using lease lease-back agreements to construct SFP new construction and modernization projects. Amendments to the Board's regulations are needed to advise on several issues as follows:

- ❑ The District must have title to the site on which the project will be constructed at the time that the apportionment is approved by the SAB.
- ❑ The lease agreement must contain the following provisions or information:
  - The value of the lease.
  - A provision that the title to the improvements on the site shall vest with the District up on completion of the project.
  - A provision that the lease agreement shall terminate within 180 days of the filing of a notice of completion or occupancy of the project by the District, whichever occurs first.
- ❑ State bond funds may not be used to make lease or rental payments (EC 17070.71 (c)).

These requirements were put into proposed regulations and presented to the SAB at the September 2003 meeting.

### CONCLUSION

Increasingly, projects funded with State bond dollars are not being competitively bid. Some districts have instituted alternative selection processes, but those in use are not uniform and may or may not be effective in protecting the expenditure of public funds. Therefore, Members of the State Allocation Board may wish to consider some or all of the following:

1. Whether new construction projects which will utilize or have utilized an exemption from public bidding based on an interpretation of EC Section 17406 should continue to be presented for funding. If so, direct Staff to prepare a proposed regulation regarding requirements applicable to those projects as discussed in the section entitled "Lease Lease-Back Arrangements in SFP Projects" in this report.
2. Whether modernization projects which will utilize or have utilized an exemption from public bidding based on an interpretation of EC Section 17406 should continue to be presented for funding.
3. Whether State policy makers should investigate the claims by school districts that public agencies need better tools to deliver quality public facilities on time and in budget while also maintaining protections on the use of public funds.
4. Whether legislation is necessary to clarify the appropriate use of EC Section 17406 and to clarify, if necessary, the relationship of that section to the entire article on leases in EC Section 17400 through 17425.
5. Whether legislation is necessary to require competitive selection processes on public works projects that do not use the lowest responsible bid as a result of an interpretation of EC section 17406.

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BOARD ACTION

The Board did not accept the report. The Legislative Board members expressed interest in pursuing proposed legislation to address this issue. The Board directed Staff to:

- Capture information on how many projects are using lease lease-back agreements.
- Provide written notification to school districts to proceed with caution when using lease lease-back agreements and interpreting the law (Education Code Section 17406).
- Report at a future SAB meeting recommendations for changes to Regulations, after discussion at the Implementation Committee meeting.

## ATTACHMENT

CALIFORNIA CODES  
EDUCATION CODE  
Section 17070.71

17070.71. (a) Notwithstanding subdivision (a) of Section 17070.70, new construction or modernization funded pursuant to this chapter may be upon real property leased to the applicant school district if all of the following conditions are met:

(1) The property is leased from another governmental entity.

(2) The term of the lease is for at least 40 years after approval of the project under this chapter, or the school district has a lease for at least 25 years on federal property. The board may authorize a lesser term, of not less than 30 years only if the board finds that granting an exception to this requirement would be in the state's best interest.

(b) The applicant school district, and the facility on leased land, if any, shall comply with all laws pertaining to the construction, reconstruction, or alteration of, or addition to, school sites and school buildings.

(c) Lease costs are not eligible project or site acquisition costs under this chapter.

17072.35. A grant for new construction may be used for any and all costs necessary to adequately house new pupils in any approved project, and those costs may only include the cost of design, engineering, testing, inspection, plan checking, construction management, site acquisition and development, evaluation and response action costs relating to hazardous substances at a new or existing schoolsite, demolition, construction, acquisition and installation of portable classrooms, landscaping, necessary utility costs, utility connections and other fees, equipment including telecommunication equipment to increase school security, furnishings, and the upgrading of electrical systems or the wiring or cabling of classrooms in order to accommodate educational technology. A grant for new construction may also be used to acquire an existing government or privately owned building, or a privately financed school building, and for the necessary costs of converting the government or privately owned building for public school use.

CALIFORNIA CODES  
EDUCATION CODE Part 10.5, Chapter 4, Article 2  
SECTION 17400-17429

17400. (a) Any school district may enter into leases and agreements relating to real property and buildings to be used by the district pursuant to this article.

(b) As used in this article, "building" includes each of the following:

(1) One or more buildings located or to be located on one or more sites.

(2) The remodeling of any building located on a site to be leased pursuant to this article.

(3) Onsite and offsite facilities, utilities or improvements which the governing board determines are necessary for the proper operation or function of the school facilities to be leased.

(4) The permanent improvement of school grounds.

(c) As used in this article, "site" includes one or more sites, and also may include any building or buildings located or to be located on a site.

17401. As used in this article "lease or agreement" shall include a lease-purchase agreement.

17402. Before the governing board of a school district enters into a lease or agreement pursuant to this article, it shall have available a site upon which a building to be used by the district may be constructed and shall have complied with the provisions of law relating to the selection and approval of sites, and it shall have prepared and shall have adopted plans and specifications for the building that have been approved pursuant to Sections 17280 to 17316, inclusive. A district has a site available for the purposes of this section under any of the following conditions:

(a) If it owns a site or if it has an option on a site that allows the school district or the designee of the district to purchase the site. Any school district may acquire and pay for an option containing such a provision.

(b) If it is acquiring a site by eminent domain proceedings and pursuant to Chapter 6 (commencing with Section 1255.010) of Title 7 of Part 3 of the Code of Civil Procedure, the district has obtained an order for possession of the site, and the entire amount deposited with the court as the probable amount of compensation for the taking has been withdrawn.

(c) In the case of a district qualifying under Section 17410, if it is leasing a site from a governmental agency pursuant to a lease having an original term of 35 years or more or having an option to renew that, if exercised, would extend the term to at least 35 years.

17403. The term of any lease or agreement entered into by a school district pursuant to this article shall not exceed 40 years.

17404. Sections 17455 to 17480, inclusive, shall not apply to leases made pursuant to this article.

17405. Any lease or agreement shall be subject to the following requirements:

(a) A building or structure that is to be used for school purposes shall be subject to the provisions of Article 3 commencing with Section 17280) and Article 6 (commencing with Section 17365). A building or facility used by a school district under a lease or lease-purchase agreement into which neither pupils nor teachers are required to enter or that would be excluded from the definition of "school building," as contained in Section 17368, shall not be considered to be a "school building" within the meaning of Section 17283.

(b) Subdivision (a) shall not apply to trailer coaches used for classrooms or laboratories if the trailer coaches conform to the requirements of Part 2 (commencing with Section 18000) of Division 13 of the Health and Safety Code, and the rules and regulations promulgated thereunder concerning mobilehomes, are not expanded or fitted together with other sections to form one unit greater than 24 feet in width, are used for special educational purposes, and are used by not more than 12 pupils at a time, except that the trailer coaches may be used by not more than 20 pupils at a time for driver training purposes.

(c) The site on which a leased relocatable structure is located shall be owned by the school district, or shall be under the control of the school district pursuant to a lease or a permit. "Relocatable structure" is any structure that is designed to be relocated.

(d) For purposes of interconnection of fire alarms, buildings leased for 24 months or less shall be subject to Section 809 of the Uniform Building Code until applicable regulations proposed by the State Fire Marshal are adopted as part of Title 24 of the California Code of Regulations.

(e) Notwithstanding any other provision of law, this section shall become operative on September 30, 1997.

17406. (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. 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.

(b) Any rental of property that complies with subdivision (a) shall be deemed to have thereby required the payment of adequate consideration for purposes of Section 6 of Article XVI of the California Constitution.

17407. The governing board of any school district may enter into an agreement with any person, firm, or corporation under which that person, firm, or corporation shall construct, or provide for the construction of, a building to be used by the district upon a designated site and lease the building and site to the district. The instrument shall provide that the title to the building and site shall vest in the district at the expiration of the lease, and may provide the means or method by which the title to the building and site shall vest in the district prior to the expiration of the lease, and shall contain such other terms and conditions as the governing board of the district deems to be in the best interest of the district.

The agreement entered into shall be with the lowest responsible bidder who shall give the security that any board requires. The board may reject all bids. For the purpose of securing bids the board shall publish at least once a week for two weeks in some newspaper of general circulation published in the district, or if there is no paper, then in some paper of general circulation circulated in the county, a notice calling for bids, stating the proposed terms of the agreement and the time and place where bids will be opened.

17408. The governing board of a school district shall call and hold an election, pursuant to Section 17409 or 17412, before or after entering a lease or agreement, as the case may be, except that if the lease or agreement does not



effect an increase in the existing applicable maximum tax rate of the district, the election requirements of this section shall not apply.

17409. Before entering into a lease or agreement pursuant to this article, the governing board of the district shall call, hold, and conduct an election in the manner provided in Section 42202, except that the ballot used in the election shall contain substantially the words: "Shall the governing board of the \_\_\_\_ District purchase (a site, sites) prepare plans and specifications, (the reference to the site or sites and plans and specifications shall not be included if, prior to calling the election, the governing board of the district has acquired a site or sites or proposes to lease a site or sites and has prepared plans and specifications) and lease (a site and, sites and) (a building, buildings) to be constructed for use by the school district (designating the location of the site or sites on which the building or buildings will be constructed and generally describing the building or buildings), and, for such purposes, shall the maximum tax rate of the district be increased by not to exceed \_\_\_\_, such increase to be in effect in the \_\_\_\_ District for the years 19\_\_ to \_\_, be authorized and the amount of such increase used solely and exclusively for such purposes?"

17410. (a) If, at an election held pursuant to Section 17409, or the predecessor to that section, a majority of the electors voting on the proposition voted "Yes," the governing board may call an election pursuant to this section.

Before entering into one or more leases or agreements pursuant to this section and this article, the governing board of the district shall call, hold, and conduct an election in the manner provided in Section 42202 of the Education Code, as it existed on December 31, 1979, except that the ballot used in the election shall contain substantially the words: "Shall the governing board of the \_\_\_\_ District purchase (a site, sites) prepare plans and specifications (the reference to the site or sites and plans and specifications shall not be included if, prior to calling the election, the governing board of the district has acquired a site or sites or proposes to lease a site or sites or has prepared plans and specifications) and lease (a site, sites) and (a building, buildings) to be constructed for use by the school district (designating the location of the site or sites on which the building or buildings will be constructed and generally describing the building or buildings) and for those purposes, shall the tax rate increase authorized on (the date of the original election), be used solely and exclusively for those purposes in addition to those approved by the majority of electors at the election held pursuant to Section 17409, or the predecessor to that section, on (the date of the original election)?"

If, at the election held pursuant to this section, a majority of the electors voting on the proposition vote "Yes," the governing board may proceed pursuant to this article to use that previously authorized tax increase for the purpose or purposes authorized under that election.

(b) It is the intent of the Legislature, in enacting this section, to permit the levy of a tax to the extent authorized at an election held pursuant to Section 17409, or the predecessor to that section, as modified to permit the proceeds of that tax to be expended for the purposes authorized at the election held pursuant to subdivision(a).

17411. The governing board of the district, if the district proposes at an election held pursuant to Section 17409 to lease more than one building, may include in the ballot measure used in the election a statement that the district reserves the right to lease less than all of the proposed buildings designated in the ballot measure. If such a statement is included in the ballot measure, the governing board may at any time thereafter determine to not lease one or more of the buildings included in the ballot measure, and such determination shall not breach any obligation of the district to the voters of the district.

17412. An election held pursuant to Section 17409 or Section 17413 shall be held in conjunction with either a statewide primary or general election, or an election date specified in Section 2500 of the Elections Code.

17413. In lieu of calling an election pursuant to Section 17409, the governing board of a school district may call an election pursuant to this section. Within 10 days after the governing board has opened the proposals pursuant to Section 17417 or has adopted a resolution pursuant to Section 17418 it may accept a proposal, if proceeding under Section 17417, and execute the lease or agreement, and immediately thereafter call an election pursuant to this section.

The governing board of the district shall call, hold, and conduct an election in the manner provided in Section 42202, except that the ballot used in the election shall contain substantially the words: "Shall the governing board of the \_\_\_\_ District lease (a site (sites) and) a building (buildings) to be constructed for use by the school district (designating the location of the site or sites on which the building or buildings will be constructed, and generally describing the building or buildings and the cost thereof), and, for such purposes, shall the maximum tax rate of the

district be increased by not to exceed \_\_\_\_\_, such increase to be in effect in the \_\_\_\_\_ District for the years 19\_\_ to \_\_\_\_\_, be authorized and the amount of such increase used solely and exclusively for such purposes?"

17414. If, at the election held pursuant to Section 17409 or Section 17413, a majority of the electors voting on the proposition vote "Yes," the governing board may proceed pursuant to this article.

17415. Whenever the electors of a school district, at an election held pursuant to Section 17409 or 17413, have approved an increase in the maximum tax rate of the district for the purpose of enabling the district to enter into a lease or agreement for a site or building, or both, and before the lease or agreement is entered into, or during the term of the lease or agreement, territory is taken from the district and annexed to or included in another district by any means, the acquiring district shall automatically assume and shall pay to the district from which the territory is transferred a proportionate share of any remaining payments due under the lease or agreement, as the payments become due, for so long as the lease or agreement runs.

The acquiring district's proportionate share shall be in the ratio which the total assessed valuation of taxable property in the transferred territory bore to the total assessed valuation of taxable property in the whole district from which the territory is transferred for the year immediately preceding the date on which the transfer became effective for all purposes. This section shall be applicable only with respect to transfers of school district territory which become effective for all purposes after the effective date of enactment of this section, and shall be applicable whether the election under Section 17409 or 17413 occurred prior to or after the effective date of this section.

17416. (a) Unless the time allowed for the governing board to enter into the lease agreement is extended pursuant to subdivision (b), if the governing board of the district fails to enter into a lease pursuant to this article within three years after an election, held pursuant to Section 17409, at which a majority of the votes cast favors the proposition submitted, the authorization for an increase in the maximum tax rate shall become void.

(b) If litigation is filed challenging in any way the election held pursuant to Section 17409 or the competitive bidding proceedings or contract for the construction of the building to be used by the district; compliance with the California Environmental Quality Act; or the validity of or the proceedings for the issuance of any bonds, notes, warrants, or other evidences of indebtedness of a nonprofit corporation to be sold to finance construction of the building, the authorization for an increase in the maximum tax rate shall not become void because of the failure of the governing board to enter into a lease pursuant to this article until three years after the date upon which this subdivision becomes effective. This subdivision shall apply only to school districts which had an average daily attendance of 65,000 or more in the 1975-76 fiscal year.

17417. After the governing board of a school district has complied with Section 17402, it shall, in a regular open meeting, adopt a resolution declaring its intention to enter into a lease or agreement pursuant to this article. The resolution shall describe, in any manner to identify it, the available site upon which the building to be used by the district shall be constructed, shall generally describe the building to be constructed and state that the building shall be constructed pursuant to the plans and specifications adopted by the governing board therefore, shall, if that is the case, state the minimum yearly rental at which the governing board will lease real property belonging to the district upon which the building is to be constructed, and shall state the maximum number of years for which the school district will lease the building or site and building, as the case may be, and shall state that the proposals submitted therefore shall designate the amount of rental, which shall be annual, semiannual, or monthly, to be paid by the school district for the use of the building, or building and site, as the case may be. The resolution shall fix a time, not less than three weeks thereafter for a public meeting of the governing board to be held at its regular place of meeting, at which sealed proposals to enter a lease or agreement with the school district will be received from any person, firm, or corporation, and considered by the governing board. Notice thereof shall be given in the manner provided in Section 17469. At the time and place fixed in the resolution for the meeting of the governing body, all sealed proposals which have been received shall, in public session, be opened, examined, and declared by the board. 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. The board is not required to accept a proposal, or else reject all bids, on the same day as that in which the proposals are opened.

17418. (a) As an alternative to obtaining sealed proposals as required by Sections 17407 and 17417, the governing board may, in a public meeting, adopt a resolution declaring its intention to enter into a lease or agreement pursuant to this article with a nonprofit public benefit corporation organized under the Nonprofit Public Benefit Corporation Law (Part 2 (commencing with Section 5110) of Division 2 of Title 1 of the Corporations Code) if the articles of incorporation or bylaws of the nonprofit public benefit corporation provide both of the following:

- (1) That no person shall be eligible to serve as a member or director of the corporation except a person initially approved by resolution of the governing board of the school district.
  - (2) That no part of the net earnings of the corporation shall inure to the benefit of any member, private shareholder, individual, person, firm or corporation excepting only the school district.
- (b) The resolution adopted by the governing board shall do all of the following:
- (1) Describe, in a manner to identify it, the available site upon which the building to be used by the district shall be constructed.
  - (2) Generally describe the building to be constructed and state that the building shall be constructed pursuant to the plans and specifications adopted by the governing board therefore.
  - (3) If that is the case, state the minimum yearly rental at which the governing board will lease real property belonging to the district upon which the building is to be constructed.
  - (4) State the maximum number of years for which the school district will lease the building, or building and site, as the case may be.
- (c) Any building constructed by a nonprofit public benefit corporation pursuant to a lease or agreement entered into pursuant to this section shall be constructed under a contract awarded to the lowest responsible bidder pursuant to Article 42 (commencing with Section 20670) of Part 3 of Division 2 of the Public Contract Code.

Section 17424 applies to the contract.

17419. Any bonds, notes, warrants, or other evidences of indebtedness to be issued by a nonprofit corporation to finance the construction of a building pursuant to a lease or agreement entered into pursuant to Section 17418 shall be sold pursuant to Chapter 10 (commencing with Section 5800) of Division 6 of Title 1 of the Government Code.

17420. All bonds, notes, warrants or other evidences of indebtedness referred to in Section 17419 and the interest thereon, and all bonds, notes, warrants, or other evidences of indebtedness issued to refinance any bonds, notes, warrants, or other evidences of indebtedness referred to in Section 17419 and the interest thereon, are exempt from all taxation in the state other than inheritance, gift and franchise taxes.

17421. Any building constructed for the use of a school district pursuant to this article is subject to Sections 17280 to 17313, inclusive.

17422. For the purposes of Sections 15102 and 15106 and Chapter 6 (commencing with Section 16000) of Part 10, 50 percent of any remaining payments for use of the building or site and building which would become due from the district under any leases and agreements entered into by the district pursuant to this article, if the leases and agreements were to run their full term, shall be considered outstanding bonded indebtedness.

17423. No district shall enter into any lease or agreement pursuant to this article if at the time 50 percent of any remaining rental payments for use of the building or site and building which would become due from the district pursuant to this article, including the lease or agreement to be entered into, if the leases and agreements were to run their full term, plus the total amount of district bonded indebtedness outstanding at the time, shall exceed 7.5 percent for elementary school districts and high school districts and 12.5 percent for unified school districts of the taxable property of the district as shown by the last equalized assessment of the county or counties in which the district is located. For the purpose of this section, the taxable property of the district shall be determined upon the basis that the district's assessed value has not been reduced by the exemption of the assessed value of business inventories in the district or reduced by the homeowners' property tax exemption.

17424. The governing board of the school district shall obtain the general prevailing rate of per diem wages from the Director of the Department of Industrial Relations for each craft, classification or type of workman needed for the construction of the building and shall specify in the resolution and in the notice, required by Section 17417, or in the resolution required by Section 17418 and in the lease or agreement made pursuant to this article, what the general prevailing rate of per diem wages and the general prevailing rate for holiday and overtime work in the locality is for each craft, classification or type of workmen needed for the construction of the building. The holidays upon which such rate shall be paid need not be specified by the governing board, but shall be all holidays recognized in the collective bargaining agreement applicable to the particular craft, classification or type of workmen employed on the project.

Any agreement or lease entered into pursuant to this article shall require that such general prevailing rates will be paid. It shall also require that work performed by any workman employed upon the project in excess of eight hours



during any one calendar day shall be permitted only upon compensation for all hours worked in excess of eight hours per day at not less than 1 1/2 times the basic rate of pay. There may also be included in leases or agreements entered into pursuant to this article any other requirements with respect to matters related to the subject of this section which the governing board deems necessary or desirable.

17425. The provisions of this article prevail over any provisions of law which conflict therewith.

17426. All acts and proceedings taken prior to the effective date of the enactment of this section, by or on behalf of any district under this article, or under color of this article, for the authorization of an increase in the maximum tax rate of the district and for the leasing of a building or buildings for the purposes of the district are hereby confirmed, ratified, validated, and declared legally effective. This shall include all acts and proceedings of the governing board of the district and of any person, public officer, board, or agency, heretofore done or taken upon the question of the authorization of the tax rate increase or the leasing. Whenever an election has been called and held prior to the effective date of the enactment of this section, for the purpose of submitting to the voters of any district the question of an increase in the maximum tax rate of the district and for the leasing of a building or buildings for the purposes of the district, the election and all proceedings attendant thereon are hereby confirmed, ratified, validated, and declared to be legally effective for all purposes, and the tax rate increase, if authorized by the required vote and in accordance with the proceedings heretofore taken, shall be a legal and valid authorization, in accordance with its terms, and any tax heretofore or hereafter levied pursuant to that authorization shall be legal and valid. The foregoing provisions of this section shall operate to supply any legislative authorization that may be necessary to validate the acts and proceedings heretofore taken which the Legislature could have supplied or provided for in this article. The foregoing provisions of this section shall be limited to the validation of acts and proceedings to the extent to which the same can be effectuated under the California and United States Constitutions. The foregoing provisions of this section shall not operate to confirm, ratify, validate, or legalize any act, proceeding, or other matter the legality of which is being contested or inquired into in any legal proceeding now pending and undetermined or which may be pending and undetermined during the period of 30 days from and after the effective date of this section, and shall not operate to confirm, ratify, validate, or legalize any act, proceeding, or other matter which has heretofore been determined in any legal proceeding to be illegal, void, or ineffective. In any school district in which an election was called and held prior to the effective date of this section in which the voters of the district authorized an increase in the maximum tax rate of the district and the leasing of a building or buildings for the purposes of the district, the law in effect at the date of the school district election shall govern the terms of the lease, the terms of the sale of related bonds, notes, and warrants, and the school district's maximum bonded indebtedness, and Section 17423 shall not be applicable to the school district's entry into any lease or agreement authorized at an election called and held prior to the effective date of this section.

17427. The State Allocation Board shall consider community school pupils housed in leased facilities that do not conform to the requirements of Part 2 (commencing with Section 2-101), Part 3 (commencing with Section 3-089-1), Part 4 (commencing with Section 4-403), and Part 5 (commencing with Section 5-102), of Title 24 of the California Code of Regulations as unleased for the purposes of determining priority for the leasing of portable classrooms pursuant to Chapter 14 (commencing with Section 17085) of Part 10.

17428. The governing board of a school district may lease property in an adjoining school district for garage, warehouse, or other utility purposes or may purchase property in an adjoining school district for those purposes and may dispose of the property in the same manner as property within the boundary of the district is purchased and disposed of. The power of eminent domain shall not be applicable and the acquisitions by purchase shall be subject to the approval of the governing board of the school district in which the property is located.

17429. (a) This section shall apply only to a school district in which the electorate authorizes an increase in the maximum tax rate of the district pursuant to this article for the lease of one or more schools, and there exists at the time of the election on a site owned by the district a school facility not owned by the district meeting all of the requirements of Article 3 (commencing with Section 17280) of this chapter, which site and school facility are designated and described in the ballot proposition approved by the voters.

(b) Notwithstanding any other law, a school district may lease from a California nonprofit corporation an existing school and may pay rentals therefore from funds derived from the increase in the maximum tax rate approved by the voters at an election. The purchase price of the school paid by the nonprofit corporation to the owners of the school shall not exceed the actual audited cost of construction thereof including actual interest paid on money borrowed to

finance such construction. Prior to the purchase of the school by the nonprofit corporation, an independent certified public accountant shall be retained by the school district to verify the actual cost of construction and any interest paid to finance the construction, and the nonprofit corporation may conclusively rely upon any certificate or opinion setting forth the actual cost of construction and the interest prepared by the independent certified public accountant.

(c) A school district, the electorate of which, prior to the effective date of this section, authorized an increase in the maximum tax rate in the manner, for the purposes, and under the circumstances specified in subdivision (a), may avail itself of the authority afforded by subdivision (b).

**Exhibit C**

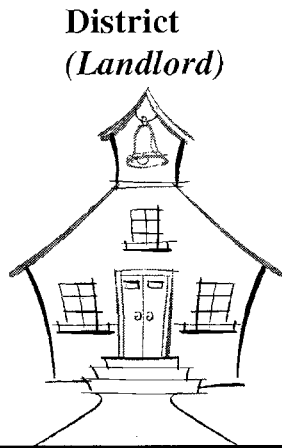
Exhibit A



# SCHOOL DISTRICT LEASE-LEASEBACK CONTRACTING

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## 1. Site Lease



District  
(Landlord)

Pay \$1/year rent

*Education Code 17406*

Right to Occupy Project

Contractor  
(Tenant)

• No competitive bidding required because Contractor pays District

---

## 2. Sublease

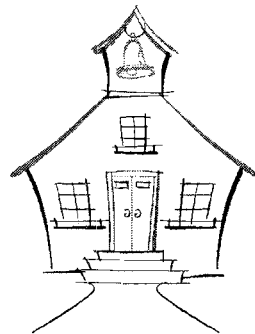
District  
(Tenant)

Right to Occupy Project

*Education Code 17417*

Pay construction/carry costs prorated over term of sublease

Contractor  
(Landlord)



• Competitive bidding required because District pays Contractor.  
  
- Competitive bidding ensures District gets best deal and pays least amount.

# On Local School Bonds, Big Donors Often Win Big Contracts

By Will Carless and Wendy Fry | Posted: Tuesday, February 19, 2013 5:55 am

If you donate more than \$5,000 to a school bond campaign in San Diego County, you have a good chance of getting the often lucrative contracts that follow.

A four-month Voice of San Diego investigation into local school bond campaigns, including public records gathered by NBC 7 San Diego, revealed a pervasive pattern: In 13 of the 17 local school districts that have issued bonds since 2006, a significant correlation exists between the major donors to the district's bond campaign, and the companies that won work on the bond program.

Overall, more than 70 percent of companies that donated more than \$5,000 to those campaigns also won bond-funded contracts.

And several donors were awarded contracts without going through an open, competitive process. Rather, they were hand-picked by district officials and school boards, or were chosen by a selection process that bypassed long-standing safeguards designed to ensure the public is getting the best possible deal.

Passing a school bond in California takes serious money.

There are consultants to pay and mailers to print. There are campaign signs to erect and robocalls to record. It's a complicated, costly process that can take months of planning and often requires tens or even hundreds of thousands of dollars.

"You can't bake-sale your way to a bond measure," Tim Baird, superintendent of the Encinitas Union School District, likes to say.

Luckily for California districts, private companies are willing to spend big cash to boost bond campaigns. Construction firms, architects, lawyers and investment banks all stand to make a lot of money from school districts if their bond measures are successful.

Those donations aren't supposed to influence districts when it's time to start handing out work to finance and build projects paid for by the bonds. School officials and trustees are supposed to pick the firms that will give taxpayers the best deals on loans, financial and legal advice, and construction work.

But in some districts, the number of big donors that also received contracts was striking.

Eight companies donated more than \$5,000 each to the campaign for Poway Unified School District's Proposition C, which passed in 2008. Seven of those firms won contracts with the district.

Five companies gave the Oceanside Unified School District's Proposition H campaign more than \$5,000 in 2008. They all won contracts to work on the bond program.

Every one of the 12 companies that contributed more than \$5,000 to the Grossmont Union High School District's Proposition U campaign in 2008 won a contract from the district.

The subjectivity involved in handing out hundreds of millions of dollars in taxpayer-funded work, combined with the fact that large campaign donors often end up winning contracts, has government watchdogs, lawmakers and other regulators concerned.

"This is a quid-pro-quo that would be illegal in just about any other circumstances," said former Assemblyman Chris Norby, who introduced a recent bill aimed at barring bond underwriters from contributing to school bond campaigns. "Can you imagine a politician getting money from a company and then saying, 'You're going to get all of my business from now on?' He'd be in jail for sure."

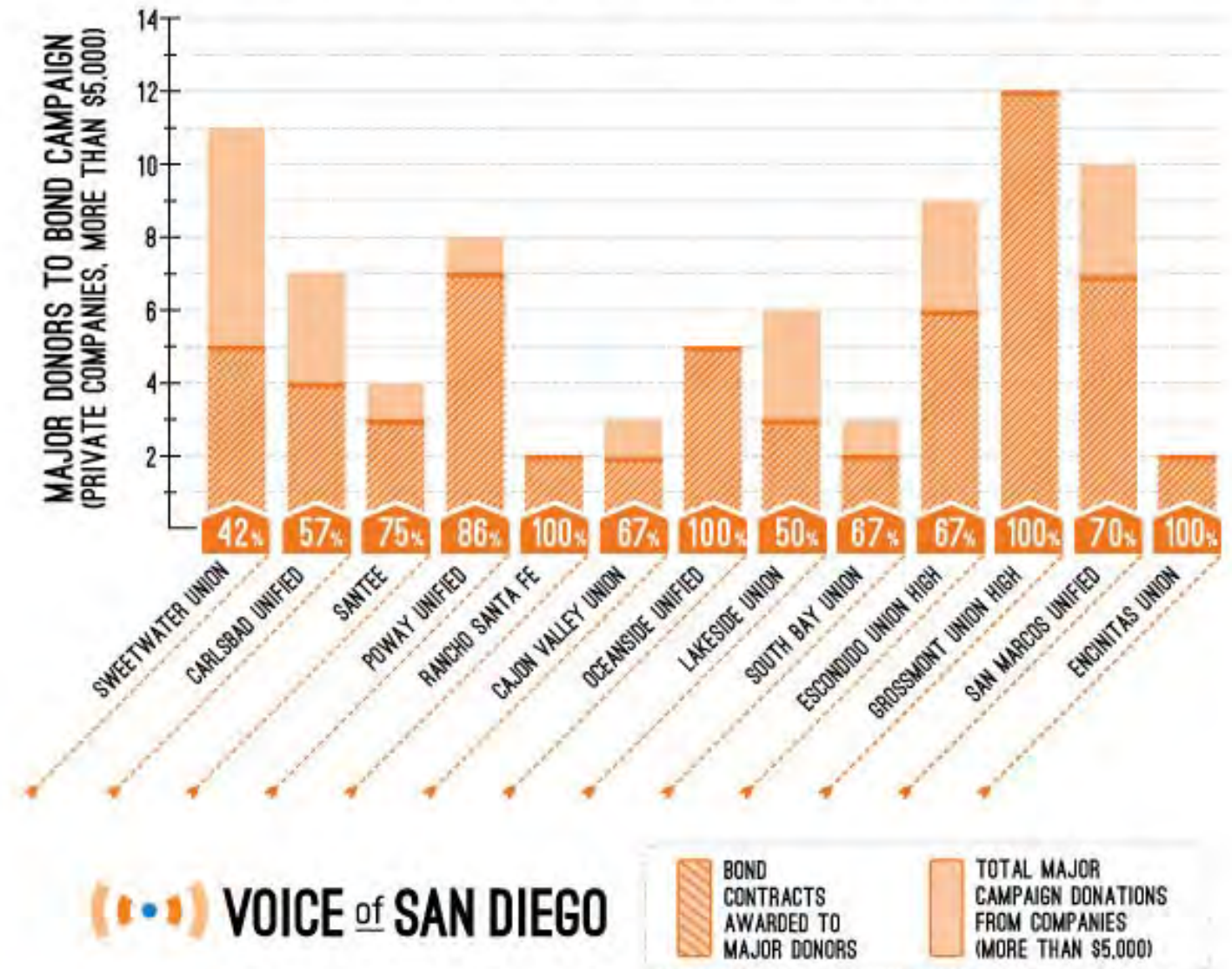
Donations aren't a guarantee of work. At some districts, donations of more than \$10,000 did not result in contracts for the donors. Similarly, some of the biggest winners from local school bond programs didn't donate a cent to bond campaigns.

School district officials across the county said donations to bond campaigns have no impact on who is selected for contracts. The staff members who choose which companies win contracts often don't have any idea who has donated money, officials said.

However, aware of the negative connotations of awarding contracts to big donors, some local districts have started to limit the donations they take from firms that will later compete for their business.

And even in districts that have no limits, officials acknowledged the current system is far from perfect.

# SCHOOL BONDS [DONORS vs CONTRACTS]



## 'A Little Awkward'

Last fall, Scott Buxbaum was trying to get the Proposition C bond campaign for the Cajon Valley Union School District in El Cajon across the finish line. So, Buxbaum, the district's deputy superintendent of business services, picked up the phone.

He called an investment bank that underwrites hundreds of millions of dollars in school bonds nationwide and is a generous donor to local school bond campaigns.

He heard something he wasn't expecting.

The company would only write a check to the campaign if the district was prepared to sign a contract stating that it would underwrite Cajon Valley's bonds, Buxbaum said.

"I told them, 'No, well that's not going to happen,'" and hung up, Buxbaum recalls. "I felt a little awkward."



When districts issue bonds, an underwriter agrees to buy the whole bond issue for a fee, often hundreds of thousands of dollars. The company then sells the bonds to investors, netting a profit on the transaction.

Bond underwriters, often large Wall Street banks, are typically some of the highest-paid of all the firms that contract with a school district. And they're big donors to school bond campaigns.

Unlike construction firms, which are usually awarded contracts only after a district has considered bids from several companies, underwriters seldom undergo a competitive bidding process to win a district's bond business.

Rather, school boards negotiate bond sales directly with underwriters — they agree on a fee and negotiate over the interest that will be paid on the bonds. In large deals, minute differences in interest rates could amount to hundreds of millions of extra dollars the taxpayers will ultimately pay to borrow money.

That has long concerned some California legislators, bond industry regulators and industry insiders, who worry that underwriters can buy access to bond business with large campaign donations.

In 2011, a bill sponsored by Norby sought to ban underwriters from working on bond programs to which they had previously donated. It died in a state Senate committee.

Norby said the bond campaign process has been "hijacked by Wall Street." Expensive campaigns are now bolstered by Wall Street banks, a far cry from PTA groups going door to door to promote school bonds, he said.

"There's no honest community debate," Norby said.

Two similar bills sponsored by then-state Sen. Roy Ashburn in 2010 also died in a Senate committee.

A letter to Ashburn from Stratford Shields, then-managing director of Morgan Stanley, laid out the bank's reasons for supporting tighter rules on donations.

"There are many cases where there is an appearance that only the contributing firms to a bond ballot election committee have an opportunity to compete to provide financial services for the bonds," Shields wrote.

School bond underwriting across San Diego County has been dominated by six firms since 2006. In that time, those companies donated more than \$280,000 to bond campaigns between them. Almost every time an underwriter donated more than \$5,000, it won a lucrative contract to underwrite the district's bonds.

In 2011, the underwriter Stone & Youngberg netted \$813,751 for underwriting Poway Unified School District's now-infamous billion-dollar bond deal.

Poway's bond campaign committee had received \$25,000 from Stone & Youngberg four years earlier.

The Sweetwater Union High School District paid two underwriters almost \$1 million combined to buy their bonds in 2008. One of those underwriters was Alta Vista Financial, Inc., which donated almost \$50,000 to Sweetwater's bond campaign committee 16 months earlier.

Trading bond underwriting work for campaign donations is against the law, according to the California Legislative Counsel Bureau, which provides nonpartisan legal advice to state legislators.

"It is our opinion that a school district or other local agency may not condition the award of an agreement to provide bond underwriting services on the underwriter also providing campaign services in support of that bond measure," Legislative Counsel Diane F. Boyer-Vine wrote in a 2010 letter to then-state Sen. Roy Ashburn.

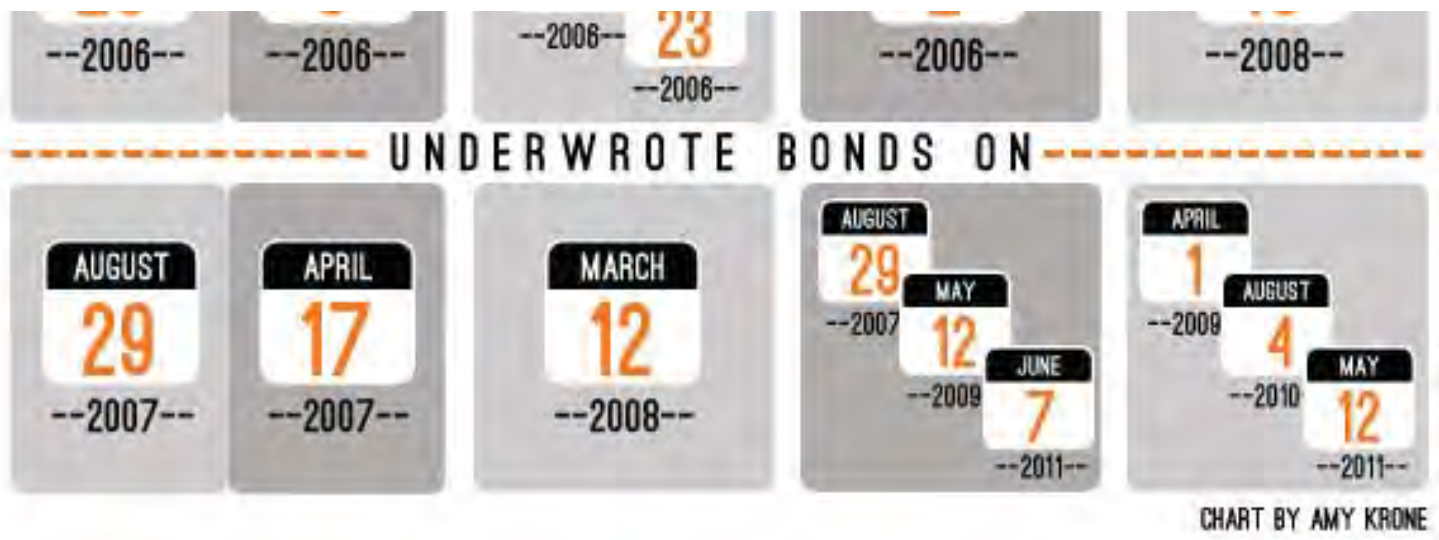
The bond underwriters contacted for this story did not respond to calls for comment.

A spokeswoman for one company, Piper Jaffray & Co., emailed a statement:

"We will not make, or indicate a willingness to make, any financial contribution as a condition to being retained as an underwriter," she wrote.

## VOICE of SAN DIEGO





## The Rise of the Lease-Leaseback

Once a school district has sold its bonds, it's time to hire construction firms: architects to design the buildings, construction managers to oversee projects and general contractors to run each construction site.

Traditionally, a California district would hold an open bidding process for those jobs. It would solicit bids, and choose the company that could perform the work for the lowest price.

That method of choosing contractors is fast disappearing in San Diego County. It's being replaced by a process called "lease-leaseback."

In a lease-leaseback, a school district leases a piece of property to a developer, usually for \$1 a year. The developer then leases that property back to the district while it is building on the site. The "rent" the district pays over time for this second lease finances the cost of the project's construction.

This method allows a district to contract directly with a developer without holding a competition to see who can build the project for the lowest price.

While school district staffers usually evaluate various bids before awarding a lease-leaseback contract, this process breaks with longstanding requirements to award public construction contracts to the lowest bidder, said Kevin Carlin, a local attorney.

Carlin is suing the Sweetwater Union High School District over its use of lease-leasebacks. He said the requirement to award a contract to the lowest bidder removes any subjectivity from the decision-making process and keeps the system fair.

And he said the lease-leaseback method has been bastardized from its original purpose — to help districts that couldn't afford to fund projects upfront.

Local school district officials and private construction firms have begun to use lease-leasebacks primarily to avoid awarding contracts based solely on price, Carlin said.

"Anytime you introduce the possibility to deviate from the lowest sealed bid, you introduce the opportunity for influence, favoritism, possibly fraud, possibly corruption," Carlin said.

**"Anytime you introduce the possibility to deviate from the lowest sealed bid, you introduce the opportunity for influence, favoritism, possibly fraud, possibly corruption."**

In recent years, large construction firms that donated to local bond campaigns have consistently been awarded such contracts by local school districts.

In Poway, two local construction firms wrote large checks to the school district's Proposition C campaign in 2008. Douglas E. Barnhart, Inc. donated \$49,999. Echo Pacific Construction, Inc. donated \$60,000.

Barnhart was awarded two lease-leasebacks. Echo Pacific hit the jackpot — it was awarded 13 lease-leasebacks under the district's bond program.

In Sweetwater, two of the four companies chosen to complete lease-leasebacks for the district's Proposition O bond, which passed in 2006, had earlier contributed more than \$5,000 to the bond campaign.

### **'It's Our School District'**

David Dudley's company, West Coast Air Conditioning, donated \$10,000 to the Cajon Valley Union School District's Proposition D campaign in 2007. Dudley's family trust donated another \$20,000 on the same day.

West Coast Air was subsequently awarded a lease-leaseback to build the Cajon Valley Middle School, the largest project built with Proposition D dollars.

Dudley acknowledged that some local districts have earned bad reputations for their bond practices, but said not all districts, or all companies, should be tarred with the same brush.

West Coast Air has been building projects for the Cajon Valley district since 1962, he said.

"It's our school district," Dudley said. "My kids have gone through the school district. A lot of the people who work here's kids are in the district, so we've had a long, long relationship with them performing work and also on the community side."

School district officials across the county similarly cautioned against drawing connections between donations and lease-leaseback contracts.



Lease-leasebacks offer districts — and taxpayers — all sorts of benefits that don't exist when companies are chosen simply on the basis of cost, said Baird of Encinitas Union.

Just as an individual homeowner wouldn't necessarily choose the cheapest craftsman to repair his home, Baird said, districts should be able to choose contractors based on experience and their prior relationship with the company.

And the notion that districts can be bought for a few thousand dollars is ridiculous, he said.

### **Avoiding a 'Subconscious Response'**

The need to ask companies for money, combined with a district's ability to hand out contracts based on factors other than cost, creates an atmosphere that's ripe for corruption, said Bob Stern, former president of the Center for Governmental Studies, a now-defunct watchdog group in Los Angeles.

"They're not going to say that they look upon donors favorably," Stern said. "But studies always show that there's a subconscious response in these situations."

**"They're not going to say that they look upon donors favorably. But studies always show that there's a subconscious response in these situations."**

To avoid even the perception of pay-to-play, some districts have started to proactively limit the amount they will take from donors.

Buxbaum said the Cajon Valley district's 2012 bond campaign placed a \$2,000 limit on contributions, specifically to send a message that contracts couldn't be bought.

Other districts haven't followed suit.

The second-largest successful school bond campaign in San Diego County last year was Proposition AA at the San Dieguito Union High School District. The measure asked voters to approve the district selling almost half a billion dollars' worth of bonds.

The campaign contributions list for Proposition AA is a who's who of construction and bond finance firms.

Five companies each donated \$25,000 to the district's bond campaign, including one underwriter, three architects and one large construction firm.

If history is any guide, those five companies stand a very good chance of being awarded a contract at some point in the near future.

***Update:** We've changed the reference to NBC7 to more accurately reflect the station's involvement in this story.*

*Will Carless is an investigative reporter at Voice of San Diego and Wendy Fry is a reporter for NBC 7 San Diego. You can reach them at [will.carless@voiceofsandiego.org](mailto:will.carless@voiceofsandiego.org) and [Wendy.Fry@nbcuni.com](mailto:Wendy.Fry@nbcuni.com).*

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# Money Makes the Monkey Dance

By Kevin Carlin | Posted: Thursday, February 28, 2013 5:15 pm

The data correlation between campaign contributions and lease-leaseback contract awards summarized in Will Carless' recent article reminds us of the adage from the organ grinder era, "money makes the monkey dance."

This still rings true today about the hundreds of millions of taxpayer dollars school boards have lavished on their favored contractors over the last decade by awarding inflated no-bid, lease-leaseback contracts.

Since the 1950s, the Education Code has allowed school districts that did not have sufficient funds to immediately pay for construction to lease property to another person. That person, through sealed competitive bidding based on approved plans and specifications available to all interested bidders, offered the lowest rental price to construct and then lease the completed school facility back to the school district. The district leased the facility over a period of years to recover the cost of construction, plus the cost of financing the project.

Unfortunately for the last decade, California's school districts have not been strictly complying with the lease-leaseback provisions of the Education Code to finance school construction in their districts.

Instead, districts are encouraging contractors to finance bond passage campaigns in return for a tacit understanding that those districts will subsequently award lavish bond funded contracts to those same contractors.

As proven in Poway and countless other school districts, taxpayers lose on both ends of the bond/construction process. They end up paying too much on the front end to borrow the bond money — Poway taxpayers will pay more than a billion to borrow \$105 million — and they end up paying too much on the back end to have their school facilities built by the bond-passing contractors, which do not have to really compete with other contractors for no-bid, lease-leaseback contracts.

Promoters of this perverted form of lease-leaseback contracting assert the contracts are awarded by a "competitive proposal process."

While such a process appears fair and fiscally prudent at first glance, the dirty secret is that contractor selection is done prior to final plans and specifications being approved for construction.

Consequently, there is no objective basis by which to obtain an "apples to apples" comparison of proposals. Moreover, selection is not even based on price (because the real price cannot be defined without final plans). Instead each contractor proposes an estimated "guaranteed maximum price" that will be adjusted later based on final plans and subcontractor bids.

No surprise, at the end of the day, districts end up paying at or above the "guaranteed maximum price" suggested during the "competitive proposal process." What is known for sure during the "competitive proposal process" is which contractor contributed the most to the passage of the district's bond campaign or sponsored the last annual school building staff conference or hosted the last golf trip to Napa or delivered the last bag of cash to a school official at a restaurant.

But of course supporters of the current lease-leaseback process would have you believe none of that would or could have anything to do with which contractor is awarded a contract for millions of dollars of taxpayer money.

**Exhibit C**

As a result of their financial, marketing and political efforts, a small cartel of contractors, consultants and school attorneys are profiting tremendously by persuading school boards to enter into lease-leaseback contracts that do not have the advantages of sealed competitive bidding or provide real project financing over a period of years, as required by the Education Code.

The lease-leaseback cartel contends Education Code Section 17406 exempts them from competitively bidding the sublease by which the school districts pay for the costs of construction.

It's an invalid assertion because Education Code Section 17406 only applies to the lease of the site from the district to the contractor (competitive bidding is not required because contractor pays the district). Education Code Section 17417 applies to the sublease of the site from the contractor back to the district (competitive bidding is required because district pays the contractor).

Presently, school districts are not soliciting proper competitive bids on their sublease agreements from all interested contractors and awarding their contracts, if at all, only to the lowest responsive and responsible bidders, as required by Education Code Section 17417.

The contractors and others profiting from this lack of competitive bidding use the false argument that you would not go with the lowest bid if you were building your own home, so why would you expect a school board to use competitive bidding when awarding multimillion-dollar construction contracts? (Indeed, a school district superintendent used this exact example in Carless' investigation.)

The taxpayers in Poway and many other school districts in California can give you billions of reasons why the justifications asserted by the lease-leaseback cartel are egregiously wrong.

*Kevin Carlin is a local attorney and principal of the Carlin Law Group. He is currently suing the Sweetwater Union High School District over its use of lease-leasebacks.*

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*Want to spark discussion? Start a conversation by submitting a commentary at [Fix San Diego](#).*



# Superintendent Says Cash Exchange was for Campaign

By [Wendy Fry](#)

| Saturday, Aug 4, 2012 | Updated 8:11 AM PDT

Source: <http://www.nbcsandiego.com/news/local/south-bay-butchershop-164964266.html#ixzz2SkTtvGnr>



The superintendent of San Ysidro schools said in a June 20 deposition that he accepted \$2,500 in cash from a contractor in 2010 in the parking lot of the Chula Vista Butcher Shop, a South Bay restaurant that has since been renamed the Steak House.

San Ysidro schools superintendent Manuel Paul said the money was for a campaign contribution for board member Yolanda Hernandez.

"It was cash given to me by Mr. Loreto Romero," Paul said. "He gave me cash for campaign posters for Mrs. Yolanda Hernandez." Paul later added the amount was about \$2,500.

Hernandez did not respond to multiple requests for comment made over several weeks.

Loreto Romero concurred with Paul's description of the cash exchange, saying the money was a political donation. When pressed, Romero admitted he was hoping to compete for a construction management contract with the school district at the time the money was dropped off.

A donation from Romero does not appear on any [campaign finance forms](#) available on the San Diego County Registrar's website for Hernandez and the county campaign services supervisor confirmed Friday that no amendments have been made or filed recently.

Even if the money was a political donation, San Diego State political science professor Brian Adams said exchanging that much cash breaches state campaign finance laws.

"For cash, it's \$99 for what you can receive. Everything else has to be in a check," said Adams, who has written a book on local and state campaign finance laws.

Paul's deposition was taken as part of a lawsuit brought by Chula Vista-based Manzanita Energy, a solar panel company suing the district for breach of contract. The approximately \$18 million services contract would have allowed the school district to purchase solar power from political consultant Art Castañares' company, Manzanita or EcoBusiness Alliance - another business name for Manzanita.

Under the deal, San Ysidro agreed to buy power generated by the panels from Manzana Energy over 25 years for a flat fee of \$18.9 million. Manzana was to pay \$16 million to buy and install the panels, which would have generated about 70 percent of the schools' power needs. School district officials estimated at the time that the deal would save San Ysidro \$10.5 million in energy costs over the 25 year life span of the contract.

The equipment was supposed to be installed in early February 2008, but not one panel had been put into place when the contract was terminated in October 2011. Because no panels were installed, no district funds were ever spent on the endeavor.

Castañares' is building a case that his contract was terminated because he refused to "pay to play."

In the deposition, Paul said he took the cash from Romero to a business in Tijuana to make posters for Hernandez's election campaign.

"That's completely illegal. And it's very clearly illegal," said SDSU professor Adams, who said that all campaign cash must be deposited into a campaign account and then expenditures made from that account to promote transparency.

"You can of course amend your form and that does frequently happen with candidates who make mistakes, but the initial mistake is still there and they can still be fined for that. Also, what's typical in these types of cases is the money has to be returned. Now, I don't know if they've returned the money, but it is very likely they will be required to return the money to the contributor."

San Diego County District Attorney Bonnie Dumanis is prosecuting six current and former officials in the neighboring Sweetwater school district for their role in what she has described as a pervasive and systemic "pay to play" atmosphere. Dumanis said the Sweetwater officials traded their votes on key contracts in exchange for Lakers tickets, Halloween costumes, expensive meals and other entertainment.

In an email statement in response to questions about the 2010 cash exchange, Paul wrote:

*"We are in the middle of litigation with EcoBusiness System I am not willing to discuss anything relative to pending litigation. Apparently your interest involves information you have learned from a deposition. I am surprised that you would have a deposition that has not been filed in court in your possession. That being said, I believe that there are ulterior motives by parties to this case which relate to an effort to pressure an improper resolution. That will not occur, and I will not allow my position to be used for such a purpose. I must respectfully decline your request to go camera. I believe that the issue you have discussed with others in my office has been completely obfuscated. I believe the proper reporting regarding campaign contributions have been made."*

NBC7 asked Paul why he was collecting campaign money on Hernandez's behalf, as he is not listed as her campaign manager or treasurer in disclosure forms, but he has not yet responded to that question.

During the Fall 2010 cash exchange in the parking lot, San Ysidro schools was accepting bids for construction on a new school, Vista Del Mar. According to Paul's testimony in the deposition, companies who competed for the contract included: Echo Pacific, Barnhart Balfour Beatty, Erickson Hall, GI Construction Management, Seville Construction Management and HAR Construction Management, a company headed by Loreto Romero's brother, Hector.

Erickson Hall eventually won the contract.

The San Ysidro school district consists of seven schools serving about 5,200 students in kindergarten through eighth-grade, along the U.S. border with Mexico.

# Gala prize was Napa weekend with contracting official

The administrator says there's no conflict in subsequent, unrelated, award of \$4 million contract

By [Tanya Sierra \(/staff/tanya-sierra/\)](#) 6:02 p.m. Oct. 29, 2010



[\(/photos/2010/oct/29/251323/\)](#)

Silverado Resort and Spa

A top administrator for Southwestern College went on a Napa Valley wine and golf getaway with a construction executive three weeks before the man's company was awarded a \$4 million contract with the college.

The contractor, Echo Pacific Construction of Escondido, paid \$15,000 to "win" the trip during a silent auction fundraiser for the school's auxiliary foundation. Part of the prize was spending the weekend with Nicholas Alioto, vice president for business and financial affairs, who plays a key role in handing out district contracts.

The foundation raises money for college scholarships and to support school construction efforts. In March, it hosted just under 500 people at a "Havana Nights" themed gala at the Loews Coronado Bay Resort in Coronado.

Alioto said it is normal for people to bid on auction items that include dinner or outings with decision-makers and that his participation in the weekend at Silverado Resort and Spa in late June was not a financial conflict of interest.

Alioto's portion of the trip cost \$1,800. It would be illegal for him to accept gifts in excess of \$420 a year directly from a contractor. But his portion of the trip was covered by the foundation, avoiding any legal issue.

"There wasn't anything that wasn't completely above board," Alioto said. "The foundation paid directly for the costs."

On July 14, the Southwestern College board granted Echo a \$4 million construction management contract recommended by Alioto for The Corner Lot, a \$59 million administration center, plus a bookstore, food court, art gallery and wellness center in Chula Vista.

Alioto said the contract award had nothing to do with the Napa outing, and added that decisions about contracts are handled by many people, not just him.

Still, "It doesn't pass the smell test," said San Diego State University business management and ethics professor Jai Ghorpade, who has taught courses in ethics and human resources management in his 35 years at the college.

"What you have is an ethical problem," he said, adding that Alioto's participation violates "norms and moral codes. That shouldn't be going on there."

Although Echo won the Napa retreat, the company's president, Chris Rowe, was not the only contractor to accompany Alioto.

**Exhibit E**

Henry Amigable of Seville Construction Services came along, as did Paul Bunton of BCA Architecture — the company that purchased the trip and donated it for the silent auction.

The group spent the weekend at the Silverado Resort and Spa, which boasts nine swimming pools, two 18-hole golf courses, 13 tennis courts more than 400 rooms on 1,200 acres.

“We golfed and had dinner and went on some wine tastings,” Alioto said.

This past summer, Alioto came under fire when he hosted a wine-and-cheese fundraiser for college board trustees Yolanda Salcido and Terri Valladolid — inviting many contractors to give money to the incumbents’ campaigns. Alioto said there was no problem with the fundraiser, which he said he hosted because he fears for his job if the two are ousted.

BCA, Seville and Echo have donated more than \$35,000 combined to Salcido and Valladolid.

Many at the South County college campus who have become disenchanted in recent years with the administration and board of directors are suspicious of the wine country trip and Alioto’s fraternizing with district vendors.

“You are dealing with companies that have donated tens of thousands of dollars to incumbents,” said faculty union President Andy MacNeill. “While it may be legal, it is highly suspect.”

Rowe did not return a message left on Friday to seek his comment on the trip.

Alioto said his participation was an effort to raise funds for the college foundation, which made about \$154,000 at the Havana Nights gala.

The fact that many political and foundation donors have contracts with the district should not cause alarm, Alioto said.

“I’ve been very careful to make sure that we always have a large group of people in the selection process so nobody can say that one person is making these types of decisions,” Alioto said.

Other silent auction items at the Havana Nights gala included a sushi dinner with college president Raj Chopra, which sold for \$6,500 to GKK Architects, Alioto said. The dinner will be prepared by Amigable of Seville at Chopra’s downtown San Diego condominium for eight to 10 guests.

“They were competing for a spot on The Corner Lot and they didn’t get it,” Alioto said. “So you are certainly not guaranteed a contract if you give generously at the gala. It’s not a sure fire way to win.”

According to IRS forms that nonprofit organizations must make available for public viewing, the foundation spent more on supporting the college’s effort to raise funds for construction than it did on student scholarships.

Tax documentation shows the foundation spent \$45,525 on student scholarships and spent \$75,000 on construction efforts. Foundation president J.R. Changtengco did not return calls to answer questions, including what kinds of efforts the foundation makes for construction projects and why that’s a nonprofit activity.

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# South Bay corruption probe triples in size

By [Aaron Burgin \(/staff/aaron-burgin/\)](#) 7:38 p.m. Jan. 7, 2013

A corruption probe in the South Bay tripled in size Monday, as 15 people faced 232 felony and misdemeanor counts in the scandal involving construction contracts at three South Bay school districts.

The defendants appeared in response to indictments issued in secret last month by a criminal grand jury that interviewed more than 60 witnesses and reviewed 1,400 pages of documents.

District Attorney Bonnie Dumanis is building a case that officials accepted meals, sporting events, plays, campaign contributions and other considerations in exchange for multimillion dollar school bond construction contracts.

Prosecutors had charged four officials last year, all with ties to Sweetwater Union High School District — former Superintendent Jesus Gandara, school board members Pearl Quiñones and Arlie Ricasa and former board member Greg Sandoval. They have pleaded not guilty.

Now, the case has expanded to include more officials at Sweetwater and others at two other school districts — the San Ysidro School District and Southwestern Community College District.

Four of the five sitting board members at Sweetwater — Ricasa, Quiñones, Bertha Lopez and Jim Cartmill — now stand accused. So does the current superintendent and a board member at San Ysidro — Manuel Paul and Yolanda Hernandez.

Also, five departed officials at Southwestern face indictments — former Superintendent Raj Chopra; former vice president Nick Alioto; former board members Jorge Dominguez and Yolanda Salcido; and former administrator John Wilson.

“We go where the evidence takes us,” District Attorney Bonnie Dumanis said in a prepared statement. “And in this case it took us to a much larger, more tangled web of corruption than we originally uncovered.”

Attorneys for the defendants said after the court hearing that they plan to prove their client’s innocence.

“Pearl could have cut in line and done what others have done and got out of line by pleading to misdemeanors,” Quiñones’ attorney, Marc Carlos, said. “But she is standing by her principles because she believes she didn’t do anything wrong.”

Paul Pfingst, who represents Gandara, echoed Carlos’ statements.

“These charges are extremely disturbing to him,” Pfingst said of Gandara.

Investigators began reviewing relationships between contractors and school officials in the South Bay after a series of stories by The Watchdog in 2010 and 2011.

At Southwestern, the stories highlighted such events as a Napa Valley getaway at which contractors paid for a chance to rub shoulders with school administrators — and went on to win contracts. At Sweetwater, coverage focused on a bridal shower Gandara held for his daughter, inviting contractors and vendors to give to a “money tree” in her honor.

Two contractors are also among those facing new charges: Gary Cabello, a bond issuance agent for both Sweetwater and Southwestern and Jeffrey Flores, president of Seville Construction Services.

Three other people with connections to the scandal are cooperating with authorities: Henry Amigable, who worked for Seville, pleaded guilty to a misdemeanor in May and is working with county prosecutors; Jaime Ortiz, an executive with Pasadena-based SGI Construction who managed Sweetwater’s \$644 million bond program; and Rene Flores, president of SGI.

The 59-page indictment details how contractors showered key elected and appointed officials with tickets to Chargers football games and took them to high-end restaurants, plays and the like. According to court documents:

- Cabello on June 27, 2008, took Sandoval to a Padres baseball game and dinner at Donovan’s Steakhouse, which cost \$860.
- On Oct. 30, 2008, Cabello also took an unknown number of Southwestern representatives to Fleming’s Prime Steakhouse & Wine Bar for \$1,111.
- On June 16, 2007, Amigable spent \$985 on a dinner for Quiñones and her friend at Baci restaurant.

- On March 14, 2008, Amigable bought Ricasa and Sandoval dinner at Island Prime Restaurant for \$1,011.
- In November 2007, Amigable and Ortiz took Quiñones, Sandoval and their friends and family to the musical “Jersey Boys.”
- Cabello on Sept. 30, 2009 and another person bought a \$708 dinner at Churrascaria restaurant for Alioto, Wilson, Salcido and Chopra.
- On Jan. 16, 2010, Ortiz bought Chargers tickets for Sandoval, valued at \$688, but Sandoval, according to court documents, was not pleased with the quality of the seats.

The counts added Monday include extortion charges against several officials, not part of the initial round of charges in Sweetwater. According to the indictment, elected officials accepted gifts with the understanding they would award the contractors lucrative contracts.

“As such, (the defendants) created a “pay-for-play” environment,” the indictment reads.

Cabello’s former firm, Alta Vista Financial, received underwriting services contracts with Sweetwater during the time Cabello was showering officials with gifts. Jeffrey Flores, the president of Seville Construction Services, won a \$2.7 million Proposition R contract with Southwestern College in November 2009 after a series of dinner and drink outings with officials.

Elected officials failed to report these gifts on state-mandated statements of economic interest, prosecutors allege.

The 16-member grand jury was empaneled from Nov. 7 to Dec. 21. All told, prosecutors said, they have compiled more than 57,000 pages of documents.

Supporters and opponents of the accused officials packed Judge Timothy Walsh’s courtroom Monday afternoon.

The defendants were scheduled to be arraigned on the charges. All but one of them delayed entering a plea until Jan. 30 to give their attorneys more time to comb through the indictment, which they said they had received earlier in the day.

Cabello pleaded not guilty to five counts, including bribery and conspiracy.

Pfingst said the attorneys are considering splitting the case into two, one dealing with the Sweetwater and San Ysidro school districts and the other dealing with Southwestern College.

“We have to see what happens after we have gotten a chance to sift through the documents,” Pfingst said.

Three of the defendants — Alioto, Chopra and Hernandez — did not appear in court today for various reasons. They are also scheduled to appear on Jan. 30.

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## **A quick guide to the South Bay corruption case**

By **JAMES PALEN**, The Daily Transcript  
Wednesday, May 1, 2013

The ongoing South Bay school corruption cases involve 13 active or former area school officials, a construction bond underwriter and the president of a construction firm. All 15 defendants have pleaded not guilty to various charges, ranging from extortion and conspiracy for some to bribery and the intentional filing of false documentation for others. Most of them are charged with multiple counts of each of their alleged crimes. The acts detailed in the indictments deal in large part with the interactions of the school officials, who would carry out votes on who would handle construction and banking activities for projects approved by their districts, with bond underwriter Gary Cabello and **Seville Construction Services** President Jeffrey Flores. The indictments cover many years' worth of accusations, highlighting acts such as a dinner reported to have been bought by Cabello for representatives of the Southwestern Community College District at Fleming's Steakhouse around Oct. 30, 2008 – a dinner reported to have cost him more than \$1,100. In all, the indictments laid out more than 200 charges against the 15 defendants.

### **Gary Cabello**

Bond underwriter, formerly of Alta Vista Financial Inc. and Cabrera Capital Markets LLC.

--Charged with conspiracy, offering a valuable thing to a member of a governing board of a school district, offering a valuable thing to a member of a governing board of a community college district and giving or offering bribes.

### **Jeffrey Flores**

President of Seville Construction Services

--Charged with conspiracy, offering a valuable thing to a member of a governing board of a school district, offering a valuable thing to a member of a governing board of a community college district and giving or offering bribes

--Represented by Courtney Pilchman, **Pilchman & Kay PLC**

### **Manuel Paul**

Former superintendent of the San Ysidro School District.

--Charged with filing false instrument, perjury by declaration and receiving gifts as a public official from a single source in excess of the legal amount.

-- Represented by James Fitzpatrick, **Law Offices of James M.V. Fitzpatrick**

### **Yolanda Hernandez**

San Ysidro School District governing board member.

--Charged with filing false instrument and perjury by declaration.

--Represented by Michael Crowley, **Crowley Law Group**

### **Nicholas Alioto**

Former Southwestern College vice president.

--Charged with receiving bribes, wrongful influence by a public official, filing false instrument, perjury by declaration and receiving gifts as a public official from a single source in excess of the legal amount.

--Represented by attorney Dan Tandon, deputy public defender.

### **Raj Chopra**

Former Southwestern College president

--Charged with wrongful influence by a public official, receiving a bribe, conflict of interest, filing false instrument, perjury by declaration and receiving gifts as a public official from a single source in excess of the legal amount.

--Represented by Michael Attanasio, **Cooley LLP**

### **Jorge Dominguez**

Former Southwestern College governing board member

--Charged with filing false instrument, perjury by declaration, receiving gifts as a public official from a single source in excess of the legal amount, accepting a bribe and conflict of interest.

--Represented by Vikas Bajaj, **Law Office of Vikas Bajaj APC**

**Yolanda Salcido**

Former Southwestern College governing board member.

--Charged with accepting a bribe, conflict of interest, filing false instrument, perjury by declaration, receiving gifts as a public official from a single source in excess of the legal amount and wrongful influence by a public official.

--Represented by attorney Dale Santee, deputy alternate public defender.

**John Wilson**

Former director of facilities at Southwestern College.

--Charged with receiving a bribe, filing false instrument, conflict of interest, perjury by declaration, receiving gifts as a public official from a single source in excess of the legal amount and wrongful influence by a public official.

--Represented by Kevin B. McDermott, **Law Offices of Kevin Barry McDermott**

**James Cartmill**

Active Sweetwater Union High School District governing board member

--Charged with wrongful influence by a public official, accepting multiple bribes, conflict of interest, filing false statement, perjury by declaration and receiving gifts as a public official from a single source in excess of the legal amount

--Represented by Thomas Warwick, **Grimes & Warwick**

**Jesus Gandara**

Former Sweetwater Union High School District superintendent.

--Charged with extortion conspiracy and multiple counts of receiving bribes, conflicts of interest, filing false instruments, perjury by declaration, receiving gifts as a public official from a single source in excess of the legal amount and wrongful influence by a public official.

--Represented by Paul Pfingst, **Higgs Fletcher & Mack LLP**

**Bertha Lopez**

Active Sweetwater Union High School District governing board member

--Charged with filing false instrument, perjury by declaration, receiving gifts as a public official from a single source in excess of the legal amount, accepting bribes, wrongful influence by a public official and conflicts of interest.

--Represented by Dean Schiffman, **Schiffman & Huch LLP**

**Pearl Quinones**

Active Sweetwater Union High School District governing board member

--Charged with extortion, conspiracy, accepting bribes, conflict of interest, wrongful influence by a public official, filing false instrument, perjury by declaration and receiving gifts as a public official from a single source in excess of the legal amount.

--Represented by Marc Carlos, **Bardsley & Carlos LLP**

**Arlie Ricasa**

Active Sweetwater Union High School District governing board member.

--Charged with extortion, conspiracy, accepting bribes, conflict of interest, filing false instrument, perjury by declaration, receiving gifts as a public official from a single source in excess of the legal amount and wrongful influence by a public official.

--Represented by attorney Allen R. Bloom

**Gregorio Sandoval**

Former Sweetwater Union High School District governing board member.

--Charged with extortion, conspiracy, accepting bribes, conflict of interest, filing false instrument, perjury by declaration, receiving gifts as a public official from a single source in excess of the legal amount and wrongful influence by a public official.

--Represented by Ricardo Gonzalez, **Law Offices of Ricardo M. Gonzalez**