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ENGINEERS JOINT CONTRACT DOCUMENTS COMMITTEE

RECENT COURT DECISIONS OF RELEVANCE TO CONTRACT DOCUMENTS

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1. **Issue:** Applicability of state building codes to a project undertaken by a bi-state commission created under the U.S. Constitution's Compact Clause. *Delaware River Joint Toll Bridge Commission v. Secretary, Pennsylvania Department of Labor and Industry.* United States Court of Appeals for the Third Circuit (2021).

   Summary: In 1934 the State of New Jersey and the Commonwealth of Pennsylvania enacted laws forming the Delaware River Joint Toll Bridge Commission. As stated in the Constitution (Article I), all agreements and compacts between the states must be approved by Congress—such approval was given to the toll bridge agreement between Pennsylvania and New Jersey in 1935. The Commission was granted sweeping authority to own, construct, maintain, and operate bridges and related improvements and facilities, and to "exercise all other powers…reasonably necessary to [the Commission's] authorized purposes…," specifically including the exercise of powers with respect to its property and affairs. These broad powers were stated to be subject to an exception: the Commission was expressly denied the power to levy taxes.

   In 2017, in connection with the replacement of the Scudder Falls Bridge, the Commission purchased 10 acres of land near the bridge, on the Pennsylvania side, and proceeded with construction of an administration building for the Commission's executive and administrative staff. The Commission did not apply for a building permit.

   The Pennsylvania Department of Labor and Industry ("Department") threatened to issue a stop-work order against the project, because of the lack of a building permit, but did not do so. The Department instead attempted to assert authority over the project by singling out the project's elevator subcontractor, threatening the subcontractor with regulatory sanctions for its involvement in the Commission's building project. The Commission responded by filing a lawsuit in federal court, seeking a declaration that the Department lacked the authority to enforce Pennsylvania's building codes with respect to the Commission's project, and moving for an injunction precluding the Department from any attempted code enforcement.

   The U.S. District Court granted the Commission's motion for an injunction and injunctive relief, enjoining the Department from seeking to "inspect or approve the elevators" or from other actions attempting to impede, interfere with, or delay the completion of the elevator work. Contending that Pennsylvania had reserved its regulatory power to enforce "critical safety-based laws applying to building construction," the Department appealed.

   Decision: The first issue on appeal was a technical dispute regarding the jurisdiction of the federal courts over the Commission's declaratory action. The Third Circuit

concluded that by alleging that the Secretary of the Department would violate the Compact by enforcing the Pennsylvania building codes, the Commission had alleged an ongoing violation of federal law—as noted, the Compact was itself a product of congressional action. Further, the court concluded that a declaration requiring the Department to comply with the Compact as written did not intrude on any constitutional rights reserved to the states. Hence there was federal jurisdiction.

Based on precedent involving other multi-state compacts, the Third Circuit held that:

- "a bi-state entity created by compact, is not subject to the unilateral control" of any state, absent express language to the contrary in the compact.

- The creation of a bi-state entity pursuant to the Compact Clause is an unambiguous surrender of the two states' sovereignty.

- By creating a bi-state entity, the two states relinquished all control over the entity, unless otherwise stated in the compact.

- In this specific bi-state compact, New Jersey and Pennsylvania ceded authority over building safety regulations by granting the Commission powers to acquire property, make improvements, and "the power over all other matters in connection with [the Commission's] facilities."

- By expressly reserving the power of taxation to the states, but failing to reserve any other powers, the two states had shown that they did not intend to reserve the authority to enforce building safety regulations.

Comment: The Compact is constitutional in origin, and was drafted by the two states and approved by an act of Congress, but at its core it is a contract: "Interstate compacts are construed as contracts under the principles of contract law." Of particular interest is the point about the impact of specifically reserving the power of taxation—under basic rules of contract interpretation this supported an inference that other powers, such as the building permit/code power, had **not** been reserved. In contract drafting there is often an inclination to list or address specific items, but the drafter must consider whether doing so creates any unintended implications for other items that are not given specific attention.

The *Delaware River* decision did not discuss which standards and codes the architects and engineers who designed the administration building had actually followed. As a result of the decision the Commission was insulated from

Pennsylvania's building code requirements, but what exposure to liability would the Commission, its design professionals, and its construction contractors have in the case of an accident or calamity that could be linked to a deviation from the host state's building codes?

Questions of this same nature arose in the aftermath of the horrific events of September 11, 2001. The World Trade Center had been built by the Port Authority of New York and New Jersey, an entity formed under an interstate agreement under the Compact Clause. The buildings did not conform to certain New York building codes, including certain fireproofing requirements. The Port Authority was exempt from New York city and state code oversight at the time the World Trade Center was designed and constructed, but this alone was not necessarily a shield against all subsequent claims.

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2. **Issue:** Did a subcontractor's commercial general liability insurer have a duty to defend the project owner and construction manager in an injury lawsuit by the subcontractor's employee? *Scottsdale Insurance Company v. Columbia Insurance Group, Inc.* United States Court of Appeals for the Seventh Circuit (2020).

   Summary: TDH Mechanical provided heating, ventilating, and air conditioning construction services for a building construction project in Chicago. A TDH employee plunged through an unguarded opening and fell 22 feet, sustaining serious injuries. The employee sued the construction manager, Prairie Management and Development, and the project owner, Rockwell Properties, alleging negligent supervision and monitoring of the work of the subcontractors and of the worksite; the lawsuit also included claims against other project participants. The lawsuit did not contain any direct or express claims or allegations against TDH Mechanical, which was not subject to injury litigation by an employee, by virtue of the workers' compensation laws.

   The TDH Mechanical subcontract required TDH to carry commercial general liability (CGL) insurance under which the owner and the construction manager would be additional insureds. Columbia Insurance Group provided that insurance. After the injury lawsuit was filed, Rockwell (the owner) and its insurance company, Scottsdale Insurance, demanded that Columbia provide Rockwell and Prairie (the CM), as additional insureds, with a defense. Columbia declined, citing a clause in TDH's CGL policy that said:

   > Such person or organization [referring to the owner, and the CM] is an additional insured only with respect to liability arising out of

> your [TDH's] ongoing operations performed for that [additional] insured.

Columbia contended that because the lawsuit did not implicate or blame TDH for the injuries, the potential liability of the owner and CM did not arise out of TDH's ongoing operations, and hence there was no entitlement to defense as an additional insured.

Scottsdale Insurance filed an action in federal court seeking a declaration that Columbia Insurance had a duty to defend Rockwell and Prairie, and to reimburse Scottsdale for defense costs incurred in the interim. The district court granted the motion, declaring that Columbia had a duty to defend and awarding Scottsdale approximately $50,000 in defense costs already incurred on behalf of Rockwell and Prairie. Columbia appealed the decision to the Seventh Circuit Court of Appeals.

Decision: The Seventh Circuit affirmed the district court's decision. The court noted several key principles of insurance law that governed its analysis of the issue:

- An insurer's duty to defend is broader than its duty to indemnify (pay damages).

- The insurer can refuse to provide a defense only "if the allegations of the underlying complaint preclude any possibility of coverage."

- A policy exclusion will apply only if it is free from doubt that it precludes coverage.

- The reviewing court may look beyond the underlying complaint, to any third-party complaints, to determine the duty to defend, as long as such third-party complaints are not self-serving.

- Any doubts about the duty to defend are resolved in favor of the insured.

With respect to the "arising out of" limitation in the policy, the Seventh Circuit concluded that the limitation "does not keep Columbia off the hook to defend" because the underlying injury lawsuit suggests, and does not foreclose the possibility, "that some fault lies with TDH." For example, the allegations of the injury lawsuit referred to inadequate owner/CM supervision resulting in "subcontractors"—presumably an oblique reference to TDH—engaging in the unsafe practice of not covering or guarding dangerous floor openings during construction.

Also relevant to the analysis were the allegations by other defendants against TDH. The defendants in the injury lawsuit had filed third-party complaints against TDH, contending that TDH negligently failed to maintain safe conditions in its work area. Although allegations by the owner and CM would be disregarded as self-serving, the similar allegations by other defendants provided support for a holding that the injuries arose at least in part out of TDH's operations.

Comment: An additional insured has less protection than a primary insured (policyholder) has; in particular, as this case shows, under a typical policy an additional insured must first establish that the liability to which it is exposed has a connection back to the primary insured's operations. In the construction project context this will ordinarily not be difficult to establish, as long as "the underlying allegations do not preclude the possibility of coverage." In some cases, of course, the wording of the underlying complaint may preclude coverage, by describing alleged wrongdoing that is wholly independent of the activities of the primary insured, but this will be the exception.

Because the insurance company's duty to defend is broader than its duty to indemnify, it is possible to establish a threshold defense obligation because the underlying allegations do not preclude the possibility of coverage, but later, as the case develops, to reach the conclusion that the additional insured is not entitled to coverage. The Seventh Circuit pointed this out: "As the district court correctly concluded, the issue of indemnity can wait."

The subcontract clause requiring TDH to name the owner and CM as additional insureds was reasonably clear and not in dispute; a confirming certificate of insurance was required, and TDH furnished it.

One minor anomaly of this case is that the Court of Appeals asserts that "Prairie [CM] and Rockwell [owner] contracted with TDH…." In this author's experience, it would be very rare for an owner and CM to jointly enter into a contract with a subcontractor (constructor). If the CM here was acting merely as an advisor to the owner, then presumably it was the owner that contracted directly with TDH. If the CM was a CM at risk, then presumably the CM contracted with TDH. In either case the "subcontract" with TDH would contain a clause requiring that both CM and owner (and often other parties, such as the A/E) be named as additional insureds under the subcontractor's CGL policy.

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3. **Issue:** Determination of compliance with the statute of limitations for defective construction claims. *Fuelberth v. Heartland Heating and Air Conditioning, Inc.* Nebraska Supreme Court (2020).

   Summary: Fuelberth retained Heartland Heating and Air Conditioning to design and construct an in-floor geothermal system for a new shop building, and an exterior ice-melt system under the shop's driveway. Fuelberth and Heartland did not have a written contract, though there was a written estimate that briefly described the scope of work.

   Heartland completed the work in 2012. The exterior system failed soon after installation, and the interior system failed in the summer of 2016. On November 14, 2016, Fuelberth filed a lawsuit against Heartland. Nebraska has a four-year statute of limitations for design/construction defect claims; a 2015 Nebraska Supreme Court case established that the four years will be measured from the date of substantial completion of the project.

   After sorting through the facts regarding the completion of the work, the trial court concluded that Heartland had substantially completed the interior system in January 2012, and therefore the November 2016 Fuelberth claim regarding the interior system was not timely, having missed the statute of limitations deadline by approximately 10 months. The trial court further determined that the exterior system was substantially complete no later than November 12, 2012, and therefore Fuelberth's November 14, 2016, filing was at least two days too late. The court dismissed the Fuelberth lawsuit as barred by the statute of limitations; Fuelberth appealed.

   Decision: On appeal, Fuelberth argued that the trial court had erred in treating the interior system and the exterior system as two separate projects with two separate substantial completion dates. Fuelberth contended that the systems actually functioned together, and that it was incorrect to conclude that the interior system was substantially complete in January 2012, because the related exterior system was not yet operational at that time, and would not be completed until November 2012.

   The Nebraska Supreme Court's analysis included a discussion of when a claim had accrued, such that Fuelberth could have brought an action, and whether the Fuelberth-Heartland contract was "divisible" (allowing separate causes of action to accrue), or "indivisible," in which case legal action must be based on the contract as a whole. Under the divisibility standard, most contracts are divisible and separable. However, under the following established facts the court concluded that the Fuelberth-Heartland contract was indivisible:

- The proposed scope of work had indicated the installation of several in-floor zones, most in the shop building itself, but Zone 7 was labeled as “Ice Melt,” referring to the driveway. Listing the zones together, in a single list, suggested a single project.

- There was no breakdown of price between the interior system and the exterior system. The combined scope of interior and exterior work was priced at the lump sum amount of $78,000.

Because the contract was indivisible, the court concluded that the cause of action did not accrue until the entire project was substantially complete, in November 2012. From that point in time Fuelberth had four years to file a defective construction claim.

The Nebraska Supreme Court then pointed out that if further factfinding confirmed that the correct date of substantial completion of the project as a whole (interior and exterior) was November 12, 2012, then under the way that procedural times are calculated under Nebraska law the four-year limitation period would end on November 12, 2016—however, that date fell on a Saturday, and under the time calculation rules when a procedural deadline falls on a Saturday, the deadline is extended to the next day on which the courts are open for business, namely Monday, November 14, 2016, the very day on which Fuelberth had filed the lawsuit.

Comment: A good written contract would have defined substantial completion for purposes of the project. See EJCDC® C-700 2018, Standard General Conditions of the Construction Contract. Under the contract administration contemplated in C-700, the Engineer would have issued a certificate of substantial completion. If justified, owner and contractor could have used the specific General Conditions provisions for partial use or occupancy, and substantial completion of that part of the work, under C-700 15.04. Such steps might have clarified the status of the work and the timeline, and eliminated the need to investigate the events of 2012.

The appellate court’s discussion of accrual of causes of action, and of divisibility of a contract, were perhaps unnecessary. The four-year statute of limitations itself, and the governing Nebraska caselaw pegging measurement of the four years to substantial completion, appeared to be definitive and sufficient to decide this case. Ultimately, the court correctly focused on whether there was one project or two; the decision that it was one project, with one contract and one substantial completion date, was well supported.

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4. **Issue:** When does the six-year statute of repose begin to run for a 28-building condominium project? *D'Allesandro v. Lennar Hingham Holdings, LLC.* Supreme Judicial Court of Massachusetts (2020).

Summary: The Hewitts Landing Condominium in Hingham, Mass., is comprised of 28 separate buildings containing a total of 150 units, constructed between 2008 and 2015. In 2017 the condominium association filed a lawsuit, based primarily on tort claims, against the developer, the contractor, the construction manager, and others alleging design and construction defects in the common and limited-common areas. The alleged defects included problems with decks and columns, roofing and flashing, building envelopes, and the irrigation system.

Massachusetts has a hybrid statute of limitations/statute of repose ("Section 2B") that provides in part that "in no event" shall tort actions arising from design or construction be commenced more than six years after the earlier of:

> a. the opening of the improvement to use; or
>
> b. substantial completion and taking possession for occupancy by owner.

In federal court, the defendants sought partial summary judgment, arguing that Section 2B barred the claims with respect to 6 of the 28 condominium buildings. The federal court requested that the Massachusetts Supreme Judicial Court provide a definitive answer to the following question (paraphrased):

> When does the six-year repose period for tort claims start running when a condominium is built in a continuous construction project comprising multiple buildings?

Decision: The Massachusetts Judicial Supreme Court summarized the question as "whether the statute of repose was triggered only once [at completion of all buildings]…or whether the statute was triggered multiple times, as each individual building…met the statutory requirements [was completed or put into use]." The court concluded that as each of the 28 separate buildings was completed, a separate repose period began running for that building. The full formal answer:

> We respond to the certified question as follows: Where a condominium development is comprised of multiple buildings, regardless of how many phases of the development there may be or how many buildings are within each phase, each building constitutes a discrete "improvement" for purposes of Section 2B,

> such that the opening of each individual building to its intended use, or the substantial completion of the individual building and the taking of possession for occupancy by the owner or owners, triggers the statute of repose under Section 2B with respect to the common areas and the limited common areas of that building. In addition, where a particular improvement is integral to, and intended to serve, multiple buildings (or the condominium development as a whole), the statute of repose begins to run when that discrete improvement is substantially complete and open to its intended use.

The defendants had emphasized to the court that the local municipality had issued certificates of occupancy for each individual building—and after such a certificate was in place the buildings were in fact put into residential use. The plaintiffs countered that in the context of a continuous multi-building project it made more sense to view this as a single project with a single trigger date for the statute of repose, based on the clear completion of all construction.

The court's decision in favor of the multiple repose periods was supported by reflection on the reasons for enactment of the statute of repose. The statute of repose was a conscious effort to strike a "reasonable balance" between claimants' rights to a remedy and fairness to the construction industry. As a previous Massachusetts decision had established, without a statute of repose:

- Contractors and design professionals would need to mount a defense when design documents had already been discarded;
- Building codes may have changed;
- Witnesses may be dead or impossible to locate.

Comment: Nothing is said in this decision about the design and construction contracts. In the Nebraska case on a similar issue (item 3 above), it was significant that there was a single scope of work, and a single price for the full scope, suggesting a single project and a single date of substantial completion. Here, we may speculate that there were multiple contracts and a separate price for each building, especially given the lengthy time during which construction occurred; but this information is not in the record, and the facts may have been otherwise.

In its decision the Massachusetts Supreme Judicial Court did acknowledge that there may be "some difficulty" for condo buyers when the developer has retained control, or partial control, over a substantial period of time. Flaws or defects may arise, but the developer's incentive to address them may be low—the problems will soon pass to the condo association, and "developers are not likely to agree to sue themselves." As a

result, the window of time in which the buyers may take action may be short. The court concluded that this was a problem that was outside the court's purview, and could be addressed only by the legislature:

> If there are any inconveniences or hardships growing out of [application of the statute of repose], it is for the legislature…to apply the proper remedy."

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5. Issue: Immunity of municipal owner and construction contractor to neighbor's property damage claims. *Coolidge v. City of Waukesha and D.F. Tomasini Contractors, Inc.* Court of Appeals of Wisconsin (2020).

Summary: Tomasini was the contractor on a City of Waukesha sewer and water construction project in the rights-of-way of two city streets. Coolidge owned an adjacent apartment building, and claimed that the building was damaged by vibrations during the contractor's backfilling operations. Tomasini had used a vibratory drum roller, which according to Coolidge caused differential soil settling under its building, and resulting structural damage so severe that the building was rendered uninhabitable.

Coolidge filed a lawsuit against the City and Tomasini. Coolidge alleged that the City had negligently (a) failed to warn the contractor regarding the condition of the building (the City knew that the apartment building had been built on an old landfill), and (b) failed to require Tomasini to protect the building during construction. Coolidge also contended that Tomasini had been negligent in (a) not inspecting the apartment building prior to the backfill operations, (b) using a vibratory roller to compact the fill, and (c) not monitoring the vibrations.

The trial court conducted a hearing on Coolidge's claims, and then granted summary judgment to the City, based on immunity conferred to municipalities with respect to the planning and design of infrastructure projects, and to Tomasini, based on immunity conferred on governmental contractors that follow prescribed specifications. Coolidge appealed.

Decision: The court of appeals affirmed the trial court's decision in favor of the City and its construction contractor.

Wisconsin statutes give cities immunity for acts done in the exercise of "legislative, quasi-legislative, judicial, or quasi-judicial functions." These terms have been interpreted by the courts to confer broad immunity for any municipal act that involves "the exercise of discretion and judgment." In particular, the courts have declared that:

> Decisions concerning the adoption, design, and implementation of a public works system are discretionary, legislative decisions for which a municipality enjoys immunity.

Coolidge argued that this rule of law applies only if the municipality can show that it expressly raised and discussed the specific issue (for example, the issue of protection of the Coolidge apartment building), and then made a conscious decision between identified alternatives. The court of appeals replied that "there was no support or precedent for the proposition that individual elements (or omissions) from a project could be 'isolated from the project as a whole and, in hindsight, picked apart to defeat immunity.'" Rather, under longstanding law:

> Where, when and how to build sewer systems are legislative determinations imposed upon a governmental body. It is not for the court to be judge or jury to 'second guess' them in these determinations nor to find they are liable for negligence.

A rule requiring evidence of specific detailed decision-making during the design process, as proposed by Coolidge, would undermine the public policy behind the broad grant of municipal immunity, and hence was of no interest to the court of appeals; as the court summed it up: "We are not persuaded."

The immunity enjoyed by municipalities with respect to infrastructure projects will extend to the construction contractor if (a) the contractor is following reasonably precise specifications that that the municipality had approved, and (b) the contractor was implementing municipal decisions that themselves were entitled to immunity. The court of appeals noted that the design included 116 special provisions, a set of standard Wisconsin Department of Transportation specifications, and the specific specifications for the Waukesha sewer/water project. The court opined that "Having strictly followed those specifications, Tomasini cannot be held liable for any damages resulting from the execution of the City's plan."

Comment: Many states confer some degree of immunity to public entities with respect to negligence claims. The specific scope, rules, and procedure applicable to such immunity varies greatly from state to state.

Government contractor immunity is recognized in federal law and in some states. It is generally less broad and less likely to apply than governmental (sovereign) immunity. A related principle, the government contractor defense, applies to contractors that furnish products to the government (most notably the federal government) pursuant to detailed government specifications.

The EJCDC Construction Series documents impose duties on the Contractor with respect to damage or injury claims by the owners of properties adjacent to the construction; the duties include taking corrective or remedial action, settling claims, and indemnifying the Owner and Engineer against neighboring property damage claims. See EJCDC® C-700 (2018), Standard General Conditions of the Construction Contract, Paragraph 5.02.A.2. The interaction of these requirements in the context of municipal immunity, or of the Contractor asserting government contractor immunity, would require specific analysis.

The appellate court in the *Coolidge* case touched on a possible exception to the general rules regarding government contractor immunity. Coolidge contended that when Tomasini chose to use vibratory compacting equipment, Tomasini was exercising its right to choose the means and methods of construction, rather than carrying out the requirements of detailed government specifications. The court of appeals found that contention to be inaccurate, because the specifications did in fact prescribe the compacting procedures, expressly limiting the contractor's options to two specified types of compaction equipment, and specifically precluding use of certain other categories of equipment. Nonetheless, the court's consideration of the contention suggests that a contractor that is otherwise complying with government specifications might not enjoy immunity for the consequences of "means and methods" actions—potentially a significant exception.

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6. **Issue:** Enforceability of pay-if-paid clauses under Nevada law**.** *APCO Construction, Inc. v. Zitting Brothers Construction, Inc.* Supreme Court of Nevada (2020).

   Summary: APCO Construction was the general contractor on a Las Vegas construction project that ground to a halt in late 2008. APCO subcontracted wood-framing, sheathing, and shimming work to Zitting Construction. The subcontract stated that payment to Zitting was conditioned on APCO's receipt of payment from the project owner, Gemstone—as the Nevada Supreme Court described it, this was "known colloquially as a pay-if-paid clause."

   Various lawsuits and mechanics liens followed in the aftermath of the project's failure. Zitting's lawsuit claimed it was owed $750,000 for work completed, including retainage and change order work. APCO had never received payment from the owner, and defended against the Zitting claim based on the subcontract's pay-if-paid clause.

The trial court granted partial summary judgment in Zitting's favor, ruling that the pay-if-paid provisions were void and enforceable under Nevada law.

Decision: On appeal, the Nevada Supreme Court came to the same ultimate conclusion as the lower court, but emphasized that pay-if-paid clauses are not *per se* unenforceable in Nevada; rather, the courts must consider whether the subcontract payment provision in question complies with or violates the specific terms of a Nevada statute establishing payment rights of subcontractors. Enforceability is strictly a function of the statute, not of broader principles, and a statute-based case-by-case analysis is needed:

> The District Court therefore erred in outright concluding that pay-if-paid provisions are void and unenforceable without considering the specific contract terms and whether the provisions were permitted under statute.

The controlling statute, NRS 624.628(3), lists certain subcontract provisions that are against public policy and void—for example, requiring a lower-tiered subcontractor to waive listed rights. The statute contains cross-refences to various other statutory provisions, such as a statute that creates a right to prompt payment.

After conducting an analysis of the Zitting subcontract with respect to the governing statute (and its cross-referenced subsidiary statutes), the Nevada Supreme Court concluded that the pay-if-paid provision was unenforceable, under a specified statute, because the clause limited Zitting's right to prompt payment.

Comment: The *Zitting* decision provides the Nevada courts with clear guidance on the process to use when analyzing the enforceability of a pay-if-paid clause, and rightly emphasizes the importance of the statutes concerning payment and liens. However, in reviewing these statutes it is difficult to think of a true "pay-if-paid" clause that would not be contrary to Nevada law. The *Zitting* court expressed its desire to "resolve any confusion that parties may still have regarding the enforceability" of pay-if-paid clauses in Nevada, and certainly there will be no question moving forward that it is essential to follow the process of drilling down to the specific statutory line items. Nonetheless it would have been helpful to see an example of an enforceable pay-if-paid provision.

The slight disconnect here may simply be a matter of semantics and categorization. Perhaps the "pay-if-paid" clauses that are enforceable under Nevada law would be labeled "pay-**when**-paid" clauses in other contexts.

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7. **Issue:** Disgorgement of construction contract proceeds. *Davis v. Fresno Unified School District.* Court of Appeal of California (Fifth District) (2020).

   Summary: This is a brief report on a complex matter that is not yet fully resolved.

   In 1957, the California legislature enacted a "lease–leaseback" law that authorized public school districts to use an alternative process for building urgently needed new schools. The districts were allowed to avoid competitive bidding and traditional financing (bonds) by leasing the school site to a contractor, which would build the school and then lease it back to the district for up to 40 years, after which full ownership would pass to the district.

   Eventually some school districts abused this process by using leases with a very short duration, followed by full payment of the contractor from state bond funds—in essence, a sham arrangement to avoid competitive bidding and award contracts to favored contractors.

   In the Fresno litigation, a rival contractor (and taxpayer) sued to challenge a lease–leaseback arrangement that the taxpayer contended (a) had arisen out of conflicts of interest involving the successful contractor having embedded itself as a consultant to the school district, and (b) was allegedly in violation of various terms of the lease–leaseback law.

   The various aspects of the case have made their way through multiple levels of the California court system. The courts ultimately supported the merits of the challenge, finding among other things that the agreements used by the Fresno school district were not truly leases with periodic rent payments, but rather were a "traditional construction contract with progress payments."

   The final issue to be resolved is whether the contractor can be forced to return the profit in the $37 million in contract proceeds it had received from the challenged arrangement—such a return is called a disgorgement. In the case cited above (from November 2020), the Court of Appeal stated that "the remedy of disgorgement is available."

   As one commentator on California politics and policy aptly summed it up, "the decision is a warning to construction companies and school officials that bending the law with sweetheart contracts is intolerable." (See on-line column by Dan Walters, *CalMatters*, December 1, 2020.)
