CONSTRUCTION
ALERT
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NEW CALIFORNIA LEGISLATION

The Legislature in this current session passed an unusually large number of bills that affect the construction community. One of those bills, AB 626, creates new rights for contractors with regard to change orders. AB 626 was the subject of a previous Construction Alert. The following is a summary of some of the other laws that relate to construction.

SB 661 - Dig Safe Act of 2016

Under current law codified at Section 4216 et seq. of the Government Code, all operators of "subsurface installations", except Caltrans, are required to become part of, participate in, and share in the cost of regional notification centers (such as USA Northern California). A subsurface installation includes any underground pipeline, conduit, duct, wire, or other structure. Persons planning to excavate must contact the appropriate regional notification center two working days in advance.

In the aftermath of the San Bruno fire storm, PG&E and other utilities came under strong pressure from the Legislature to adopt safer practices. SB 661 was passed in response to that pressure. The bill:

- **Requires an excavator to delineate the area to be excavated** before notifying the appropriate regional notification center of the planned excavation. "Delineate" means to "mark in white the location or path of the proposed excavation using the guidelines in Appendix B of the "Guidelines for Excavation Delineation" published in the most recent version of the Best Practices guide of the Common Ground Alliance" or to mark in pink if there could be confusion by marking in white.

- **Requires an operator (the utility company), before the legal start date and time of the excavation, to locate and field mark**, within the area delineated for excavation, its subsurface installations.

- **Clarifies what "two working days"** means with regard to the obligation to give notice.

- **Requires an operator to maintain and preserve all plans and records for any subsurface installation** owned by that operator as that information becomes known.

- **Beginning November 1, 2017, establishes a process for an excavator to request and obtain a continual excavation ticket** for an area of continual excavation that is required to be valid for one year from the date of issuance.

- **Prohibits an operator from holding an excavator liable for damages, replacement costs, or other expenses arising from damage to the subsurface installation where the operator has inaccurately marked the location of a subsurface installation,** and the excavator has complied with its obligations concerning notice and delineation of areas to be excavated, and regarding the use of hand tools within the **"**tolerance zone" of 24 inches on each side of the field marking by the operator.

- **Requires the Public Utilities Commission and the Office of the State Fire Marshal to enforce the requirement to locate and field mark subsurface installations and lines against operators** of gas corporations, electrical corporations, water corporations, and operators of hazardous liquid pipeline facilities. Doing so adds teeth to the requirements imposed on operators of subsurface installation.

- **Creates the California Underground Facilities Safe Excavation Board** under, and assisted by the Office of the State Fire Marshal. The Board is authorized to enforce the requirements for excavation safety under Government Code 4216 et seq. , to establish rules, regulations and standards and to coordinate education and outreach activities with regard to underground utility excavation safety.

SB 693 – Skilled and Trained Workforce Requirements

In the past several years, the Legislature has enacted legislation regarding the use of "skilled and trained" workers on certain types of design build and lease-leaseback projects, principally involving school districts. There were minor differences among the different laws. SB 693 amends existing laws so that they are more consistent and includes a common definition of skilled and trained workforce in Public Contract Code Section 2600.

SB 1170 – Stormwater Pollution Plans

Under Public Contract Code Section 1104, a local public entity, charter city, or charter county cannot required contractors on a public work projects to assume responsibility for the completeness and accuracy of architectural or engineering plans and specifications on public works projects, except as specified.

Existing law requires the State Water Resources Control Board and the Regional Water Quality Control Boards to prescribe waste discharge requirements in accordance with the National Pollutant Discharge Elimination System (NPDES) permit program established by the federal Clean Water Act and the Porter-Cologne Water Quality Control Act. These laws also regulate the discharge of pollutants from construction sites, in stormwater associated with construction activity that disturbs one or more acres of land surface.

SB 1170 prohibits a public entity, charter city, or charter county from:

- Delegating to a contractor the development of a plan, as defined, used to prevent or reduce water pollution or runoff on a public works contract (i.e., a SWPPP).

- Requiring a contractor on a public works contract to assume responsibility for the completeness and accuracy of a SWPPP developed by the public entity.

AB 1793 – Contractor Licensing and Substantial Compliance

Under California law, a contractor (including a subcontractor) must be licensed continuously during the time that it is performing a contract for construction. Section 7031 of the Business & Professions Code allows a person who has utilized unlicensed contractor to bring an action to recover amounts paid to a contractor(including a subcontractor) that was not licensed at all relevant times. Although the law recognized a defense of "substantial compliance", the contractor who had been sued was required to prove that it did not know or should not reasonably have known, it was not duly licensed. AB 1793 amends the Business & Profession Code to remove the requirement that the contractor demonstrate that it did not know or should not reasonably have known, it was not duly licensed. Under Section 7031 of the Business & Professions Code as amended by the bill, a person acting as a contractor can avoid having to disgorge payment "if it is shown at an evidentiary hearing that the person who engaged in the business or acted in the capacity of a contractor (1) had been duly licensed as a contractor in this state prior to the performance of the act or contract, (2) acted reasonably and in good faith to maintain proper licensure, and (3) acted promptly and in good faith to remedy the failure to comply with the licensure requirements upon learning of the failure."

AB 326 – Wage and Penalty Assessments

The Labor Code allows the Department of Industrial Relations to issue a wage and penalty assessment if it determines that a contractor (including a subcontractor) has failed to pay prevailing wages on a public project. The contractor may appeal, but it must post the full amount of the assessment in the escrow account. AB 326 requires the Department to release the funds from escrow no later than 30 days after either the conclusion of administrative or judicial review of the assessment or the Department has received written notice from the Labor Commissioner as to the settlement or other final disposition of the assessment.

SB 1209 – Contractor Discipline

The Legislature amended Section 7124.6 of the Business & Professions Code so that, when a contractor is disciplined, the record of discipline also is disclosed in connection with any contractor as to which the qualifier of the disciplined contractor is one of the

personnel of record. For example, if ABC Corporation were disciplined, then the discipline would also be disclosed with regard to XYZ, Inc., if the qualifier of ABC Corporation is one of the personnel of record for XYZ, Inc.

AB 2316 – School District Lease – Leasebacks

AB 2316 amends Sections 1740 and 17406 of the Education Code, which govern lease-leaseback transactions. The legislation:

- Requires a district to advertise for bids for lease-leaseback transactions;

- Allows districts to award lease-leaseback contracts based upon "best value" criteria, utilizing a competitive solicitation process; and

- Provides that if a contract entered into before July 1, 2015, for a lease-leaseback project is found invalid because it was not awarded through competitive bidding, the contractor may nevertheless recover for the reasonable costs it incurred in constructing the project (but not profit) if: (a) the contractor had proceeded with the work in a good faith belief that the contract was valid; (b) the district reasonably determines the work performed is satisfactory; (c) contractor fraud did not occur in obtaining or in the performance of the contract; and (d) the contract did not otherwise violate California law.

AB 2316 hence attempts to resolve some of the continuing uncertainty arising out of the *Davis* decision, which is discussed below and was the subject of prior Construction Alerts.

However, AB 2316 does not address the situation where a contract is found to be void because the contractor acted as a preconstruction consultant and was later awarded a lease-leaseback contract. Contractors therefore should avoid acting as both preconstruction consultant and as a contractor on the same project.

Background

Existing law allows school districts to enter into lease-leaseback transactions with contractors. In a lease-leaseback, the district leases a property to the contractor, the contractor constructs facilities and improvements on the property, and then the district leases the completed facilities back from the contractor. School districts began to use

lease-leasebacks in the 1950s as a method to obtain construction financing without violating the California Constitution, which at the time prohibited districts, without a vote of two thirds of the district's voters, from incurring any liability greater than the amount of one year's income. The California Supreme Court had ruled that a lease did not constitute a liability or indebtedness for the total amount of lease payments, but only for the payments due in any year.

In the last twenty years, districts began to use lease-leaseback arrangements to avoid competitive bidding requirements instead of as a way to obtain private financing. Although Public Contract Code Section 20111 requires school districts to award construction contracts for more than $15,000 to the lowest competitive bidder, Education Code Section 17406 does not specifically require competitive bidding for a lease-leaseback. Court decisions construing Section 17406 have confirmed that a school district may enter into a lease-leaseback agreement without competitive bidding. *See, e.g., Los Alamitos Unified School District v. Howard Contracting, Inc.*, 229 Cal. App. 4th 1222 (2014).

In *Davis v. Fresno Unified School District*, 230 Cal.App.4th 261 (2015), however, the Court of Appeal ruled that only "true" leases qualified as lease-leasebacks exempted from competitive bidding. The *Davis* decision created considerable concern as to whether a large number of lease-leaseback contracts would be considered void as having been awarded without competitive bids and had raised doubts as to the continuing viability of lease-leaseback as a procurement method.

In *Davis*, a taxpayer filed suit to challenge the legality of the lease-leaseback agreements and also alleged that the lease-leaseback contractor, Harris, had violated conflict of interest laws by acting as a pre-construction consultant and then entering into the lease-leaseback contracts to construct the project. The Court of Appeal ruled that the lease-leaseback exception to competitive bidding requirements only applies to "genuine or true leases." Just because something is called a lease does not mean it is a lease. To determine if a transaction is actually a lease-leaseback, a court must look at the substance of the transaction to determine its true character.

The Court of Appeal ruled that the terms of agreements between Harris and the District, as alleged in the complaint, demonstrated that those agreements were a sham to avoid competitive bidding and not a true lease-leaseback. The leaseback agreement called for payments to be made based on the progress of construction, which is typical of construction contracts and not of leases. Harris did not actually provide financing to the District under a facilities lease.

Finally, the leases only lasted through construction, and the District did not occupy the property prior to completion of construction. Harris hence never acted in the capacity of a landlord; the District never was a tenant. The Court of Appeal held that for an arrangement to be a true lease-leaseback that does not have to be competitively bid, the "leaseback must have a term that during which the school district uses the new buildings." The Court of Appeal therefore reversed the trial court and ruled that Davis had stated a claim that the defendants had violated the statutory requirements for competitive bidding.

Turning to Davis' conflict of interest causes of action, the Court concluded that a corporate consultant could be considered to be a public employee in some instances for conflict of interest purposes. The Court ruled, based on this conclusion, that Davis had stated a claim under Government Code Section 1090 and common law prohibitions against conflicts by alleging that Harris "served as a professional consultant to Fresno Unified and had a hand in designing and developing the plans and specification or the project" and that Harris was financially interested in the lease-leaseback agreements that utilized those plans and specifications.

In a subsequent case, *McGee v. Balfour Beatty Construction*, LLC, 247 Cal. App. 4th 235, 244 (2016), a different district of the Court of Appeal reached the opposite conclusion. The Court in *McGee* held that so long as the basic requirements of Section 17406 of the Education Code were met competitive bidding would not be required. The Court refused to follow *Davis*, which had examined whether a transaction actually constituted a lease, stating that any "effort to engraft additional requirements – such as the timing of the lease payments, the duration of the lease, and the financing – are not based on the plain language of the statute."

AB 2316 attempts to resolve some of the uncertainty created by the conflict between the *Davis* and *McGee* cases. However, as discussed above, AB 2316 does not address the effects of the *Davis* decision that concerned conflicts of interest from acting as a pre-construction consultant.

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