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presents

Public-Private Partnerships for Real Estate Development: Contract Negotiation Strategies

Allocating and Mitigating Developer and Contractor Risks in PPP Deals

A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:

Karen Williams, Principal, **Carroll Investments**, Of Counsel, **Lane Powell**, Portland, Ore.

David L. Winstead, Of Counsel, **Ballard Spahr**, Washington, D.C.

Samuel W. Niece, Counsel, **Howrey**, San Francisco

Wednesday, April 7, 2010

The conference begins at:

1 pm Eastern

12 pm Central

11 am Mountain

10 am Pacific

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[Defenses Rejected Contractor Recovers from PennDOT for Failing to Coordinate Utility Relocation on Highway Project](#)

['No-Match' Abandoned E-Verify Program to Check Employees of Government Contractors Is Extended](#)

[Trust Fund Statute Funds to Pay Subs Misspent; Executive of General Contractor Denied Protection in Bankruptcy](#)

['Pervasive,' 'Permeating' Bad Smell Can Constitute Property Damage under CGL Policy; Claim Triggered Insurer's Duty to Defend](#)

[Facilitator Takes Lead New Contract Form Allocates Liability for Not Achieving Green Building Status](#)

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Private Financing of Infrastructure in California: Overview of PPP Opportunities and Challenges

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September 1, 2008

By **W. Samuel Niece**
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California historically has relied on public monies to finance its infrastructure. The demand for infrastructure has increased dramatically as the state's population has increased. However, the availability of public revenues to fund infrastructure has not kept pace.

Accordingly, cash-strapped governments are turning to the private sector for financing, design, construction, maintenance and operation of infrastructure projects. These arrangements often are referred to as public-private-partnerships (PPPs or P3s) or Private Finance Initiatives (PFIs).

PPP models (and their associated acronyms) include:

- Design-Build (DB).
- Design-Build-Maintain (DBM).
- Design-Build-Operate (DBO).
- Design-Build-Operate-Maintain (DBOM).
- Design-Build-Operate-Turnover (DBOT).
- Concession ("public" utilities as opposed to "municipal" utilities).

When the private party provides financing, then an "F" sometimes is added to the acronym, such as DBFOM.

PPP involves two key issues: **1.)** project deliver system; and **2.)** extent of private financing.

The traditional approach to infrastructure was design-bid-build, with the public entity funding 100 percent of the design and construction (although sometimes with municipal bonds). Design-Build typically still employs 100 percent public funding. On the other hand, Design-Build-Operate-Maintain and concession projects typically involve partial or total private funding.

Design-Build

Commentators differ on whether design-build is the first step in PPP or the last step in owner-funded project delivery systems. **1/** Regardless, design-build is an essential element of almost all privately-funded infrastructure projects.

A. What is Design-Build?

A useful way to look at design-build is by what it is not. Traditional design-bid-build is a segmented, sequential process in which the owner first contracts with a design professional to prepare detailed, suitable-for-construction plans and specifications (or sometimes has them prepared by its in-house design professionals), then uses the detailed plans and specifications to solicit competitive bids for construction, and finally awards the construction contract to the low bidder.

“In the Design-Build approach to project delivery, the owner contracts with a single entity – the designer-builder – for both design and construction.” ^{2/} California Government Code §14661 (b) and California Public Contract Code §20133 (c)(2) define the term as “a procurement process in which both the design and construction of a project are procured from a single entity.” Typically, the design-build contract is awarded by some process other than low-bid competitive bidding. California Government Code §14661 (d)(3)(a)(i) provides that “[a]ward shall be made to the design-build entity whose proposal is judged as providing the best value in meeting the interest of the department and meeting the objectives of the project.” Public Contract Code §20133 provides that “[a] county may use a design-build competition based upon best value...” and defines “best value” to include “price, features, functions [and] life-cycle costs.”

Thus, design-build differs from traditional design-bid-build in two ways. First, the design and construction components are packaged into a single contract. Second, the single contract is not necessarily awarded to the low bidder after competitive bidding.

The term “design-build” generally is applied to design and construction of buildings. The term “Engineer, Procure, Construct” (EPC) generally is applied to design and construction of power and process plants. Most of this discussion applies equally to design-build and EPC.

B. Potential Advantages of Design-Build

Cost Savings: Design-build has the potential to reduce overall project cost because the design-build contractor performing the design has a better feel for the construction cost of design alternatives and thus can come up with a design that is less expensive to build – and has an incentive to do so. Another way to look at this advantage is that it moves value engineering (or “cost reduction incentive”) from after contract award (with the contractor proposing cost-reduction ideas and sharing the savings with the owner) to pre-award (with the owner enjoying most of the cost savings).

Earlier Project Completion: Design-build may result in earlier completion and occupancy of the project because there is no dead time between completion of design and start of construction. Further, the design-build contractor can begin construction of early phases of the project (e.g., grading, site utilities, foundations) before design of later phases (building envelope, interior partitions, HVAC, electrical) is 100 percent complete. This process sometimes is referred to as “fast track.”

New Technologies: Public Contract Code §3400 prohibits brand-name or model-number specifications for California public projects unless the specification lists at least two brand names and is followed by the phrase “or equal.” This makes it difficult for traditional design-bid-build to reach innovative, proprietary products – for which there may be only one brand name and no

equal. Further, substitution of a new “or equal” product for a standard product often is impracticable because of the ripple effect. The designer designs the project around current generation products, and substitution of new “or equal” products after bidding can require revisions to structural, mechanical or electrical components to accommodate the new product. Who is going to pay for these ripple changes? Design-build resolves this problem. The design-build entity selects the equipment (right down to make and model number) and then designs the building around the selected equipment, which is a more logical way to proceed. In fact, the design-build entity sometimes can obtain free design assistance from equipment manufacturers desiring that their new technologies be used.

Overall Project Optimization: Design-bid-build can suffer from sub-optimization when individual project participants optimize their own positions, often at the expense of the overall project. The total cost to the owner of a building element, such as the steel frame, includes the cost of the engineering to determine the required steel sections plus the cost of the steel. The designer has little incentive to use a sharp pencil to achieve the minimum amount of structural steel; he optimizes his own position by spending only the design time necessary to ensure that there is enough steel to meet gravity and seismic loads, often by employing conservative assumptions that may result in more steel than necessary. So, the owner may save money on design but pay for it in steel.

With design-build, on the other hand, the design-build entity has an incentive to use the optimum amount of engineering. As long as an additional dollar of engineering will save more than one dollar’s worth of steel, the design-build contractor will spend the engineering time up to the point of diminishing returns when an additional dollar’s worth of engineering saves only a dollar’s worth of steel because both the cost of design and the cost of steel come out of the same pocket.

This is not to say that design-build results in flimsy or less-safe structures. “More” (steel, concrete, etc.) is not necessarily “better.” Simply specifying extra steel or concrete in one place because the engineer does not have the time or incentive to calculate exactly how much is actually required does not improve the overall performance of the building. “A chain is only as strong as its weakest link.” If the owner wants a building with higher floor loadings, less floor deflection or resistance to a bigger earthquake than required by code, then the way to achieve this is by placing that requirement on the design-build entity up front – not by hoping that the designer will throw in some extra steel or concrete because he or she does not have time in the budget to use a sharp pencil.

This advantage becomes even more pronounced in DBOM, where the private entity will bear the costs of operating and maintaining the facility. The private entity can be expected to put more money into construction where it will reduce operation and maintenance costs and vice versa. For example, a private entity with a 35-year DBOM contract might opt for a slate roof that would last the full 35 years rather than an asphalt shingle roof that it might have to replace twice during the life of the PPP agreement.

Reduced Administrative Burden: Design-build may reduce the administrative burden on the owner because there is one solicitation, one award and one contract to administer. On the other hand, PPP agreements are complex and may require more time and money to negotiate than traditional design and construction contracts.

Earlier Cost Visibility: The total cost of the project is apparent earlier with design-build. In traditional design-bid-build, construction costs are not known until bid opening, and it is possible to spend money (and time) on a design that the owner cannot afford to build. All too often, construction bids exceed the

budget, and the project must be re-designed to bring it within the budget, thus delaying completion.

C. California's Historical Hostility to Design-Build

In general, the mode prescribed for public contracts is traditional design-bid-build, and the California Supreme Court long ago rejected design-build for public projects:

To permit each bidder to propose the plans and specifications according to which he will construct the building, not only prevents competition in bidding for the work, but gives to the board an opportunity for the exercise of favoritism in awarding the contract, instead of being required to let it to the lowest responsible bidder; for, since neither of the bidders can know of the plans and specifications under which others are making their bids, there is no standard by which the board can determine which is the lowest responsible bidder.

Ertle v. Leary, 114 Cal. 238 (1896).

The Supreme Court's antagonism toward design-build has found its way into the statutes governing contracting by California counties:

- **Public Contract Code §20124:** "The board of supervisors shall adopt plans, specifications, strain sheets, and working details for the work."
- **Public Contract Code §20127:** "All bidders shall be afforded opportunity to examine the plans, specifications, strain sheets, and working details."
- **Public Contract Code §20128:** "The board shall award the contract to the lowest responsible bidder, and the person to whom the contract is awarded shall perform the work in accordance with the plans, specifications, strain sheets, and working details...."

Those statutes describe traditional design-bid-build. Thus, they prevented counties from using design-build and provided the impetus for enactment of Public Contract Code §20133, which allows specified counties to use a specified variety of design-build, which is similar to the Government Code §14661 process for state office buildings. ^{3/} (That the California Legislature found it necessary to enact Public Contract Code §20133 to enable designated counties to use "best-value" design-build reinforces the conclusion that other counties do not have authority to use design-build and that the designated counties have authority to use only the cumbersome process set forth in §20133.)

The Public Contract Code §20133/Government Code §14661 process is somewhat similar to the design-build process employed by the federal government.

Unlike California, though, the federal government generally has been receptive to design-build. In 1994, a coalition of design and construction industry associations met with the General Services Administration and the Army Corps of Engineers, resulting in passage of the Clinger-Cohen Act of 1996, which is codified at 41 USC 253m and implemented by Federal Acquisition Regulation (FAR) Subpart 36.3.

Clinger-Cohen calls for a two-phase procedure:

- Phase One is open to all comers and deals with experience and

technical competence.

- In Phase Two a limited number of offerors (five or fewer) submit detailed concepts and pricing.
- Award is made based on price and other factors – not necessarily the lowest-priced proposal – in accordance with evaluation factors set forth in the Request for Proposals.

Unlike Clinger-Cohen, Public Contract Code §20133 and Government Code §14661 call for a single-phase procedure, with all comers submitting detailed proposals. Either the state or a county can pre-qualify offerors, in which case the §20133/§14661 process comes closer to Clinger-Cohen although the state or county has to allow all qualified firms to submit offers – as opposed to Clinger-Cohen's procedure for narrowing the offerors to a manageable number based on experience and technical competence.

There are two types of California cities: general law and charter. Construction contracting by general law cities is governed by Public Contract Code §20162, which provides that "[w]hen the expenditure required for a public project exceeds five thousand dollars (\$5,000), it shall be contracted for and let to the lowest responsible bidder after notice." But what is not set forth in §20162 is more important than what is there. There is no requirement analogous to Public Contract Code §§20124, 20127 and 20128 for plans, specifications and working details to be available for examination by the bidders or for the contractor to perform the work in accordance with such plans, specifications and working details. It appears, therefore, that in principle a general law city can contract for public works based on less than 100 percent plans and specifications, *i.e.*, procure both the design and construction of a project from a single entity, which is design-build. However, there does not appear to be any universally-applicable statutory authorization for general law cities to do "best value" or competitively negotiated procurement, so such design-build contracts would have to be awarded to the low bidder. Thus, a general law city probably cannot realize the full potential of design-build, but design-build nevertheless may be a viable alternative for certain projects.

There is, of course an exception: Public Contract Code §20175.2 authorizes "cities in the Counties of Solano and Yolo and the Cities of Stanton and Victorville" to use best-value design-build. 4/

Charter cities are not bound by state law (including the Public Contract Code) on "municipal affairs," and public works contracting is a municipal affair, generally governed by a charter city's charter and municipal code rather than state law. *Associated Builders and Contractors v. San Francisco Airports Commission*, 21 Cal.4th 352 (1999). Thus, a charter city can do best-value design-build if its charter and municipal code so authorize. Some charter cities, such as Los Angeles, have enacted charter or code provisions permitting design-build. Other charter cities, such as Santa Clara, simply have adopted competitive bidding language substantively identical to Public Contract Code §20162.

So, when dealing with a California city, the first step is to determine whether the city is general law or charter. If general law, look to Public Contract Code §20162 (unless it is Stanton or Victorville or one of the cities located in Solano or Yolo County, in which case look to Public Contract Code §20175.2). If charter, look to the city charter and municipal code (which usually are available on the city's Web site).

Or, consider the California Infrastructure Financing Act (Government Code §§5956, *et seq.*), discussed below.

Lease and Lease-Back: The Original PPP Vehicle

Several California local governments, most notably Los Angeles County, have used lease and lease-back transactions since the 1940s. In the typical lease and lease-back transaction, the governmental entity owns a parcel of land that it leases to a private entity. The private entity then builds a facility on the land and leases the land improved with the facility back to the governmental entity. Statutory authorization for such transactions is found at Government Code §§25371, 25351 and 25351.3 (counties) and Education Code §§17403 to 17414 (school districts).

Such transactions have been challenged in court on the theory that they are merely subterfuges to evade the multi-year limitation of California Constitution Article XVI, §18 ["No county, city, town, township, board of education, or school district, shall incur any indebtedness or liability in any manner or for any purpose exceeding in any year the income and revenue provided for such year, without the assent of two-thirds of the voters...."]. The courts have rejected such challenges. *City of Los Angeles v. Offner*, 19 Cal.2d 483 (1942); *Los Angeles County v. Byram*; 36 Cal.2d 694 (1951); *Dean v. Kuchel*, 35 Cal.2d 444 (1950); *Rider v. San Diego*, 18 Cal.4th 1035 (1998); *County of Los Angeles v. Nesvig*, 231 Cal.App.2d 603 (1965); *Ruane v. San Diego*, 267 Cal.App.2d 548 (1968); 56 Ops.Cal.Atty.Gen. 571 (1973).

It remains an open question whether lease and lease-back transactions must be competitively bid. The public contract competitive bidding laws apply to "public works contracts," *i.e.*, "agreement[s] for the erection, construction, alteration, repair, or improvement of any public structure, building, road, or other public improvement of any kind." Public Contract Code §1101. In *Boydston v. Napa Sanitation District*, 222 Cal.App.3d 1362 (1990), the court found a lease to be within the statutory definition of a public work, to which the competitive bidding laws apply. Nevertheless, many lease and lease-back transactions have been negotiated rather than competitively bid, apparently without court challenge. Thus, governmental entities or private parties considering negotiated lease and lease-back transactions should consider validation, as discussed below.

California Infrastructure Financing Act

The California Infrastructure Financing Act (IFA) of 1996 (codified at Government Code §§5956, *et seq.*) has its roots in 1989 legislation that enacted Streets and Highways Code §143, authorizing the California Department of Transportation (Caltrans) to enter into agreements with private entities for four privately-funded toll road demonstration projects.

A. Streets and Highways Code §143

There actually are two Streets and Highways §143s: The first was enacted in 1989 and expired on January 1, 2003, and the second was enacted in 2006 and runs through 2011.

In enacting the first Streets and Highways §143, the legislature found that:

Public sources of revenues to provide an efficient transportation system have not kept pace with California's growing transportation needs, and alternative funding sources should be developed to augment or supplement available public sources of revenue.

One important alternative is privately funded Build-Operate-Transfer (BOT)

projects whereby private entities obtain exclusive development agreements to build, with private funds, all or a portion of public transportation projects for the citizens of California.

Accordingly, Caltrans was authorized to:

solicit proposals and enter into agreements with private entities, or consortia thereof, for the construction by, and lease to, private entities of four public transportation demonstration projects, at least one of which shall be in northern California and one in southern California.

In response, Caltrans solicited proposals for demonstration projects, selected four entities and entered into contracts as follows:

- California Toll Road Co. (CTRC) for an 85-mile expressway between Sunol and Vacaville (the Mid-State Tollway).
- National Toll Road Authority Corp. for an 11-mile extension of Route 57 in Orange County utilizing the Santa Ana Flood Control Channel.
- California Private Transportation Corp. for an 10-mile, four-lane road in the median of Route 91 from the Riverside County line to Route 55 in Orange County.
- California Transportation Ventures, Inc. for a 10-mile limited access highway in San Diego County (the South Bay Expressway, State Route 125).

The Professional Engineers in California Government (PECG – the Caltrans engineers union) immediately sued in San Francisco Superior Court to block the agreements. PECG lost at both the trial and appellate levels, and the California Supreme Court denied review. 5/

Even after the litigation was resolved in Caltrans' favor, only two of the four projects were built, and only one of these still is operated as a PPP.

The Mid-State Tollway encountered serious political opposition, and the agreement was terminated in 2001.

The private entity requested that the date for start of construction for the State Route 57 (Santa Ana Flood Control Channel) project be slipped from 2001 to 2007. Caltrans denied the request, and the agreement was terminated in 2001, resulting in litigation that was resolved in 2003.

The State Route 91 (Median Express Lanes) project was completed and opened to traffic in 1995. However, it generated substantial controversy over the non-compete clause in the PPP agreement, which provided that Caltrans could not enter into a similar PPP agreement or itself construct any parallel lanes within 1½ miles on either side of the new express lanes. This clause was necessary in order to attract private capital, but once the new lanes were in place, opposition developed, with Riverside County suing Caltrans and the PPP consortium. In addition, the majority owner of the consortium lost interest in the toll road business.

In 2000, a nonprofit entity (NewTrac) was formed to issue tax-exempt bonds and buy out the project, but then-Attorney General Lockyer torpedoed that deal.

Eventually, the legislature enacted AB 1010 in 2002, which authorized the Orange County Transportation Authority to issue bonds and buy out the project, effectively repealing the non-compete clause and enabling Caltrans to add

parallel lanes. So, this has not been a PPP since 2003.

The South Bay Expressway (State Route 125) project was completed and opened to traffic in November 2007 and still is operated as a PPP.

Subsequent Amendments to Streets and Highways §143: In 2002, the legislature amended Streets and Highways §143 to preclude Caltrans from entering into any new demonstration projects after January 1, 2003. **6/**

Then, in 2006 the legislature re-opened the spigot, authorizing four more “transportation projects,” “primarily designed to improve goods movement, including, but not limited to, exclusive truck lanes and rail access and operational improvements.” **7/** The legislature initially required that PPP agreements had to be approved by legislature, but this was changed to provide that the agreements merely had to be submitted to the legislature, and the agreements would be deemed approved unless the legislature specifically disapproved them within 60 days. **8/**

B. IFA (Government Code §§5956, et seq.)

In 1996, the Consulting Engineers and Land Surveyors of California (CELSOC) sponsored and Assemblyman Aguiar introduced as AB 2660 a bill which:

would authorize state and local governmental agencies to enter into an agreement with a private entity for the design, construction, or reconstruction by, and lease to, that entity of a revenue generating infrastructure project, as specified.

PECG (the Caltrans engineers union) opposed the bill, so “state” was deleted from the preamble:

This bill would authorize local governmental agencies to enter into an agreement with a private entity....

And, a final subsection was added:

Notwithstanding any provision of this chapter, neither the state or any state agency may directly or indirectly use the authority of this chapter, nor may any governmental agency as defined in Section 5956.3, use the authority of this chapter, to design, construct, finance, or operate a state project. For the purposes of this section, a state project includes any of the following:

- (a) Toll roads on state highways.
- (b) State water projects.
- (c) State park and recreation projects.
- (d) State financed projects.

These limitations shall not prohibit the state, any state agency, or any governmental agency as defined in Section 5956.3, from utilizing authorizations contained in other provisions of law.

Key provisions of IFA include:

Applicability: IFA applies to local governmental entities (general law cities, charter cities, counties, school districts, joint powers authorities, transportation authorities) but not to Caltrans or any other state agency. (Government Code §§5956.1, 5956.3.)

Discretionary: IFA supplements existing authority rather than limits, replaces or detracts from existing authority. Local governmental entities are free to use it or not as they see fit. (§5956.2.)

Fee-producing Infrastructure: Projects must be “fee-producing,” *i.e.*, they must be “revenue-generating.” (§§5956.1, 5956.4, 5956.6(4), AB 2660 Legislative Counsel’s Digest.)

Reversion to Governmental Agency at End of Agreement Term: An IFA agreement may be for a term of up to 35 years, at the end of which the infrastructure reverts to the governmental agency. (§5956.6(a).)

Competitive Bidding Not Required: “The contractor is selected pursuant to a competitive negotiation process... utiliz[ing], as the primary selection criteria, the demonstrated competence and qualifications for the studying, planning, design, developing, financing, construction, maintenance, rebuilding, improvement, repair, or operation, or any combination thereof, of the facility... [and] shall not require competitive bidding.” (§5956.4.)

Exemption from Many Public Contracting Requirements: California law requires that public contracts include provisions relating to, among other things:

- Prevailing wages (Labor Code §1770).
- Working hours (Labor Code §1810).
- Worker’s compensation insurance (Labor Code §§3700, 1860, 1861).
- Payment bonds (Civil Code §§3247, 3248).
- Contractor licensing (Business and Professions Code §7028.15).
- Trench safety (Labor Code §6705).
- Contract based on complete plans and specifications (Public Contract Code §§20124, 20127, 20128).
- Claims of \$375,000 or less (Public Contract Code §20104).
- Escrow of retention (Public Contract Code §22300).
- Antitrust claim assignment (Public Contract Code §7103.5).
- Non-collusion affidavit (Public Contract Code §7106).
- Subcontractor listing (Public Contract Code §4100).
- Differing site conditions (Public Contract Code §7104).
- Audit (Government Code §8546.7).
- Utility relocation (Government Code §4215).

In addition, several contract provisions are prohibited in public contracts, including:

- Restrictions on indemnification (Civil Code §§2782, 2782.8).

- Absolute power to decide disputes (Civil Code §1670).
- Waiver of claims (Public Contract Code §7100).
- No damage for delay (Public Contract Code §7102).
- Tidal wave and earthquake liability (Public Contract Code §7105).
- Brand-name specifications (Public Contract Code §3400).

IFA §5956.5 does require compliance with Government Code §87100 (“No public official at any level of state or local government shall make, participate in making or in any way attempt to use his official position to influence a governmental decision in which he knows or has reason to know he has a financial interest”) and then continues:

Other than these criteria and applicable provisions related to providing security for the construction and completion of the facility, the governmental agency soliciting proposals is not subject to any other provisions of the Public Contract Code or this code that relates to public procurements.

“This code” refers to the Government Code, so §5956.5 appears to exempt IFA agreements from the public procurement requirements of the Public Contract Code and the Government Code. Note, however, that there is no exemption from requirements codified elsewhere, such as in the Labor Code, Civil Code, or Business and Professions Code.

Note also the reference to “provisions related to providing security for the construction and completion of the facility.” This is a vestige of the original draft of IFA, when it included the state. Under Public Contract Code §§10221 and 10224: “Every contract shall provide for the filing of separate performance and payment bonds” and “[t]he performance bond shall guarantee the faithful performance of the contract by the contractor.” However, §§10221 and 10224 are in the State Contract Act part of the Public Contract Code. There is no similar requirement in the Local Agency Public Construction Act part.

Thus, §5956.5 appears to exempt IFA agreements from several problematic requirements of the Public Contract Code, such as competitive bidding, subcontractor listing, prohibition of brand-name specifications, but not statutes in other codes.

California Environmental Quality Act: IFA projects eventually must comply with the California Environmental Quality Act (CEQA, Public Resources Code §§21000, *et seq.*). An environmental impact report (EIR) is not required for selection of the private entity or execution of the PPP agreement, but the private entity must prepare the EIR before “project development commences.” (Government Code §5956.6(b)(1); *Concerned Citizens Coalition of Stockton v. City of Stockton*, 128 Cal.App.4th 70 (2005).)

Performance Bond or Alternatives: The IFA requires that the PPP agreement include “security for the construction of the facility to ensure completion, and contractual provisions that are necessary to protect the revenue streams of the project.” (Government Code §5956.6(b)(2).) This probably can be either a performance bond or a letter of credit.

Limitation on Use of User Fees: User fees generated by the project cannot be siphoned off to the general fund:

User fee revenues shall be dedicated exclusively to payment of the private entity's direct and indirect capital outlay costs for the project, direct and indirect costs associated with operations, direct and indirect user fee collection costs, direct and indirect costs of administration of the facility, reimbursement for the direct and indirect costs of maintenance, and a negotiated reasonable return on investment to the private entity

(§5956.6(b)(4).)

No local agency shall levy a new fee or service charge or increase an existing fee or service charge to an amount that exceeds the estimated amount required to provide the service for which the fee or service charge is levied and a reasonable rate of return on investment, pursuant to paragraph (4).

(§5956.6(b)(5)(D).)

Public Hearings Required to Set User Fees: The public entity must conduct public hearings before setting or increasing user fees for the project. (§5956.6 (5).)

Audit: The private entity must prepare annual audit reports and make them available to the public. (§5956.6(7).)

Dispute Resolution: IFA §5956.6(b)(12) provides: "In the event of a dispute between the governmental agency and the private entity, both parties shall be entitled to all available legal or equitable remedies." This could be construed as limiting the parties' freedom to provide for binding arbitration in the agreement. However, under California Code of Civil Procedure §1281: "A written agreement to submit to arbitration an existing controversy or a controversy thereafter arising is valid, enforceable and unrevocable." In *Cary v. Long*, 181 Cal.443, 448 (1919), the California Supreme Court held that Code of Civil Procedure §1281 applies to municipal corporations. As to the potential conflict between IFA §5956.6(b)(12) and Code of Civil Procedure §1281, the Legislature demonstrated in IFA §5956.5 that it knew how to exempt IFA agreements from otherwise-applicable statutes, so its silence with regard to Code of Civil Procedure §1281 can be construed as an intent not to remove IFA agreements from the arbitration provisions of §1281. However, no court has spoken on this question, so it remains debatable.

Utilities Relocation: Utilities relocation costs are to be borne initially by the private entity as a recoverable capital cost. (§5956.7.)

Design Standards: IFA projects must comply with "all applicable governmental design standards for that particular infrastructure project." (§5956.8.)

Allowable Funding Sources: IFA projects can be fully funded by the private entity or by a combination of private, federal and local funds. (§5956.9.) State funds cannot be used. (§5956.10(d).)

C. More is Less

California's original PPP statute (the 1989 version of Streets and Highways §143) was one page. The 2006 version of Streets and Highways §143 is three pages. The 1996 IFA is seven pages. The extra verbiage consists primarily of restrictions and requirements that make PPPs more difficult to implement and thus less attractive.

Canadian Experience

PPPs originated in Europe and spread to Australia and Canada – British Columbia in particular.

In December 2007, Gov. Schwarzenegger's office began using the acronym "PBI" (Performance Based Infrastructure) to champion increased use of PPPs in California.

There has been a substantial increase in the use of PPPs in Canada in the last decade. In British Columbia, a new organization, Partnerships British Columbia (PBC), was created in 2002 to advance PPPs. PBC purports to be a private company, but it is wholly owned the British Columbia Ministry of Finance. **9/**

In California AB 1756 was introduced on January 7, 2008:

This bill would require the Secretary of Business, Transportation and Housing to establish the Office of Local Public-Private Partnerships in the agency to inform local agencies and other interested stakeholders of the role that public-private partnerships can play in financing, constructing, or operating, or any combination thereof, fee-producing local infrastructure projects.

This appears to be modeled after British Columbia's PBC. In addition, Governor Schwarzenegger has proposed:

- Expanding the types of projects, services and government entities that can enter into PBI arrangements.
- Establishing "PBI California," a center for excellence to help determine which state projects can benefit from PBI, represent the state in negotiations with PBI participants, to ensure transparency and to monitor performance. The governor says the center will empower California to build, operate and maintain infrastructure better, faster and for less.
- A \$2 billion bond issue for courthouse construction that will be leveraged with PBI financing to speed delivery, expand the number of projects and improve courthouse maintenance. **10/**

Because the state does not have broad authority for PPPs and courthouses are state facilities, the governor is likely to run into opposition from PEGC on the court plan.

Risks in Private Funding (and How to Mitigate Them)

A. Risks to Both Parties in a PPP

1. Legal Challenges

Examples include:

- PEGC's 1990 action to block the original four Streets and Highways §143 toll-road demonstration projects. **11/**
- Genevieve Graydon's 1978 action to block construction of a parking garage under a redevelopment project in Pasadena. **12/**
- Concerned Citizens Coalition of Stockton's 2003 action to block

privatization of operation and maintenance of Stockton's wastewater, water and stormwater utilities. **13/**

The Void Contract Rule: The power of a public agency to contract is prescribed by law, and a contract made in disregard of the prescribed mode is void. **14/**

Thus, if the PPP is not made in accordance with the requirements of IFA (or other applicable statute), then a court could find the PPP agreement void. When a court finds a contract void, it is void ab initio (from the beginning), not just prospectively. Thus, there can be no contractual recovery for anything either side has done. If the agreement is declared void, not only can neither side enforce it, but there is no implied liability on the part of the public entity for the reasonable value of services rendered. **15/** A void PPP would be a real mess. From the public entity's viewpoint, the project would be dead in the water. From the private entity's viewpoint, it could be out of pocket capital expenses with no way to recover them.

In the *Graydon* case, a contract for a parking garage came into existence in November 1977. A taxpayer brought a legal action seeking a declaration that the contract was illegal and prohibiting the public owner from disbursing funds in accordance with the contract. The trial court denied relief, and the taxpayer appealed. The appeals court affirmed the trial court but not until March 1980. By then, the garage was 80 percent complete. Fortunately, the appeals court denied relief, but if the case had gone the other way, the public agency would have been barred from paying the developer, and the developer could not have been compelled to complete the garage.

Validation: As a California Court of Appeal observed:

The fact that litigation may be pending or forthcoming drastically affects the marketability of public bonds.... We feel that the possibility of future litigation is very likely to have a chilling effect upon potential third party lenders, thus resulting in higher interest rates or even the total denial of credit. **16/**

Fortunately, there is a way to mitigate the risk that an agreement will be found void or that the threat of litigation will result in higher interest rates. California Code of Civil Procedure §§860, *et seq.*, provides that a public agency may bring an action to determine the validity of certain transactions. The Code of Civil Procedure merely sets up the procedure for conducting a validation action – there also must be a substantive law authorizing use of the procedure. In the case of California local public agencies, the authorization is found at California Government Code §§53510 and 53511:

As used in this article "local agency" means county, city, city and county, public district or any public or municipal corporation, public agency or public authority.

A local agency may bring an action to determine the validity of its bonds, warrants, contracts, obligations or evidence of indebtedness....

There really are two types of validation procedures: A validation procedure initiated by the public agency pursuant to Code of Civil Procedure §860 and a challenger-initiated anti-validation procedure (sometimes referred to as an "inverse validation action"), which is subject to a 60-day bar under §863. Under §869, the challenger must bring an action within 60 days or be forever barred.

Thus, a public agency can do nothing, wait 60 days and then relax if no action has been filed challenging the contract. So, why go to the trouble of initiating a validation action under §860? Because under §860 the agency can get two

rulings from the court: **1)** that the contract is the kind covered by the validation statutes; and **2)** that the contract is valid. If the agency does not bring a §860 action, then a late-filing challenger will argue that the contract is not of the type covered by the validation statutes. For example, in the *Graydon* case, the Pasadena RDA awarded the contract on November 2, 1977, but Ms. Graydon did not file her court challenge until January 26, 1978 – more than 60 days later. Ms. Graydon argued that the challenged construction contract was not the type of “contract” contemplated by Government Code §53511, the validation procedure of §§860 through 869 was not applicable and, therefore, the 60-day bar did not apply. The trial court and the appeals court disagreed with Ms. Graydon, finding that the contract at issue was the type of “contract” contemplated by §53511 and that Ms. Graydon’s challenge was barred by the 60-day limitation of §§860 and 863.

The key question in *Graydon* was the scope of “contract” as used in §53511. Interpretation of the word in court decisions ranges from the very narrow – that “contract” is synonymous with “bonds, warrants, obligations of indebtedness” – to the broader interpretation that “contracts” encompasses construction contracts. An example of the narrow interpretation is found in *City of Ontario v. Superior Court*, 2 Cal.3d 335 (1970), in which a taxpayer challenged Ontario’s bond funding and sole-source contracting for the Ontario Motor Speedway. The taxpayer did not serve his complaint in the manner prescribed by the validation procedure until 88 days after contract award. Ontario argued that §53511 made §§860, *et seq.* applicable so that the taxpayer’s action was time-barred. The taxpayer argued that §53511 did not apply because “contract” meant “bonds.” The California Supreme Court observed that the legislative history of §53511 characterized the measure as allowing “a local agency to bring an action to determine the validity of evidences of indebtedness” and that this does not include “contracts.”

Graydon is at the other end of the spectrum. The Pasadena RDA awarded Ernest W. Hahn a sole-source, negotiated contract for a publicly-owned parking garage to be built under a retail center built on air rights over the garage. The court found that if completion of the retail center was delayed because of a delay in construction of the parking garage, the RDA would not be able to pay for its bond, which were dependent upon tax increment monies from the retail center. The bonds were “intimately and inextricably bound up with the award of the [garage construction] contract. Delay in the completion of the retail center because of the delay which would have inevitably resulted if the [garage construction] contract had been competitively bid and would have had a direct bearing on the financial ability of Agency to meet its financial obligations and statutory purpose.”

IFA agreements are financial in nature and are necessary for California local government agencies to meet their statutory purposes, they most likely are subject to validation under the *Graydon* precedent.

Nevertheless, there are pros and cons to validation.

Pro: If a court accepts a validation action and rules that the PPP agreement is valid, then there is little risk of a subsequent successful legal challenge. If the public entity commits to a validation action early in the negotiation process, this may give comfort to the lenders and reduce the interest rate that the private entity will have to pay.

Con: Filing a validation action may smoke out opposition. Someone with an inclination to challenge the project may be prodded to file an opposition in the validation action while the person might miss the 60-day time limit for a reverse validation action if the public entity does not bring a validation action. There also is the possibility that the court will find the transaction is not valid.

Whether a validation action is filed or not, project participants need to build at least 60 days of stand-still time into the schedule to allow for time to run on a reverse validation action before the private party commits substantial resources to the project.

2. High Transaction Costs

PPP agreements are expensive for both the public entity and the private entity.

A PFI transaction is one of the most complex commercial and financial arrangements which a procurer is likely to face. It involves negotiations with a range of commercial practitioners and financial institutions, all of whom are likely to have their own legal and financial advisors. Consequently, procurement timetables and transaction costs can be significantly in excess of those normally incurred with other procurement options. 17/

3. Union Opposition

Governments cannot require that a contractor employ only union labor, and PPP projects generally will require payment of prevailing wages for construction. 18/ Nevertheless, unions often oppose PPPs. A solution is for the public entity, the private entity, and the local building and construction trades council to enter into a Project Stabilization Agreement (PSA) or Project Labor Agreement (PLA). Such agreements are valid and enforceable. 19/

B. Risks for the Public Entity

1. The Enron Problem

"Off-book financing" is a procedure under which a subsidiary entity has separate assets, debts and cash flow from the parent company. Enron went bankrupt using off-book financing, and credit-rating agencies have become increasingly attentive to and critical of off-book financing by private holding companies. 20/

Recently, credit-rating agencies have begun to view some PPP projects as off-book financing by the government agency and to treat PPP debt as government debt. 21/ This may result in a lowering of the government agency's credit rating, which could lead to higher interest cost for government debt.

2. Higher Costs

While PPPs may make it possible to bring an infrastructure project on line years earlier than under conventional government bond-funded approaches, a PPP in the United States is likely to cost more in the long run.

Tax-Free Government Bonds: In California, the interest paid on most state and local government bonds is exempt from federal income taxes and from California personal income taxes. 22/ On the other hand, private entity debt usually is fully taxable, so the private entity typically must pay a higher interest rate than would a public entity. For the deal to make sense, the public entity (or the users) eventually must reimburse the private entity for this higher cost of debt through higher user fees.

PPP proponents argue that private entities with experience in building and operating a particular type of infrastructure can do so more efficiently than a

governmental entity with limited experience, and this may be so, but it takes a lot of subjective increased efficiency to make up for the objective interest advantage of tax-exempt government-issued bonds. **23/**

The preceding discussion, however, views things from the narrow perspective of the local governmental entity. If the view is broadened and the transaction is examined from the perspective of government at all levels (local, state and federal), then perhaps the higher interest to pay the bond investors' tax bills is not so much of a factor because the extra interest results in tax revenues to some governmental entity and thus presumably funds some public good.

Nonprofit Corporations: Certain nonprofit corporations can issue tax-exempt bonds under certain conditions. These include "63-20 corporations."

Obligations issued by a nonprofit corporation formed under the general nonprofit corporation law of a state for the purpose of stimulating industrial development within a political subdivision of the state will be considered issued 'on behalf of' the political subdivision, for the purposes of section 1.103-1 of the Income Tax Regulations, provided each of the following requirements is met: (1) the corporation must engage in activities which are essentially public in nature; (2) the corporation must be one which is not organized for profit (except to the extent of retiring indebtedness); (3) the corporate income must not inure to any private person; (4) the state or a political subdivision thereof must have a beneficial interest in the corporation while the indebtedness remains outstanding and it must obtain full legal title to the property of the corporation with respect to which the indebtedness was incurred upon retirement of such indebtedness; and (5) the corporation must have been approved by the state or a political subdivision thereof, either of which must also have approved the specific obligations issued by the corporation. Interest received from such obligations is excludable from gross income under the provisions of section 103(a)(1) of the Internal Revenue Code of 1954. **24/**

An example is the Pocahontas Parkway PPP in Virginia. Although the project was developed by a limited liability company, a 63-20 corporation (Pocahontas Parkway Association) was formed to issue tax-exempt bonds to finance the project. The LLC was compensated for design and construction from the bond proceeds. **25/**

3. Default or Other Early Termination

The private entity in a PPP project almost always is a special purpose-entity/vehicle (SPE or SPV) that exists only for one project. If the project goes badly, the SPE can go bankrupt, requiring the governmental entity to step in and cover remaining costs in order to keep the project in operation. **26/**

4. Limited Risk Transfer

One of the justifications cited by proponents of PPPs is that the private entity takes on risks that otherwise would be borne by the government. However, this risk transfer may be illusory, as the private entities and their lenders frequently push back. **27/** An example is demand risk. With Streets and Highways §143 toll roads, the private entities assumed the risk that usage would be lower than projected but insisted on non-compete provisions in the PPP agreements. Another example is the Pocahontas Parkway in Virginia, where the Virginia DOT agreed not to "initiate, authorize, franchise or finance" any other highway crossing the James River within 3 miles of the project's bridge crossing. **28/**

But, in light rail privatizations, the private entities may be unwilling to assume ridership risk, so the public entity may make availability payments to the private entity rather than having the public entity bear the risk that ridership will be below projections. **29/**

5. Lack of Competition

The complexity of PPPs and the cost of negotiating them reduces competition. PPPs with only two or three candidates are not uncommon. The Abbotsford (British Columbia) Hospital PPP project initially attracted four potential private entities, but three dropped out, leaving the province to negotiate with a single entity. **30/**

C. Risks for the Private Entity

1. Changes in Political Leadership

Tom Bradley served as mayor of Los Angeles from 1973 to 1993. In 1986, the city decided that it needed additional office space for city employees. In 1987, the city's Chief Administrative Officer issued an RFP to developers for a project to be called "First Street North," consisting of an office tower for the city's use plus commercial, residential, community and retail space to be built on 11 acres of city-owned land between the Civic Center and Little Tokyo. In 1988, the city council entertained proposals from three developers and authorized the CAO to enter into exclusive negotiations with First Street Plaza Partners for development of the site. **31/**

Over the next several years, the developers say they expended more than \$12 million on environmental impact reports and other land use and environmental review procedures.

On July 31, 1993, Tom Bradley was succeeded by Richard Riordan, and in 1994 the city decided not to go forward with the project and terminated negotiations with the developers. They sued to recover out-of-pocket expenditures of \$12 million.

The trial court granted summary judgment in favor of the city on the grounds that contract formation requirements of the city's charter had not been satisfied, and the Court of Appeal affirmed.

Thus, it is important to ensure compliance with public contracting laws from the very beginning of interactions with a public entity.

Persons dealing with the public agency are presumed to know the law with respect to the requirement of competitive bidding and act at their peril. **32/**

In denying any recovery to the First Street North developers, the appeals court observed and recommended:

The instant case seems largely the product of size and complexity coupled with the modern phenomenon of "public-private partnerships." Given the current terms of the charter, it may be that "public-private" projects of this magnitude can only be safely undertaken by a sequence of contracts, with each successive contract protecting a party in plaintiff's position, or by a contract containing conditions subsequent or dispute resolution methods by which undecided issues will later be decided. These approaches might be cumbersome, but the alternative is the course followed here: extensive expenditure before contract resulting in exposure to significant loss in the

event of ultimate failure of the contract negotiations. **33/**

However, the court's recommendation for a sequence of contracts could run afoul of the conflict of interest prohibitions of the Political Reform Act of 1974:

No public official at any level of state or local government shall make, participate in making or in any way attempt to use his official position to influence a governmental decision in which he knows or has reason to know he has a financial interest. **34/**

"Public official" includes every member, officer, or consultant of a state or local governmental agency. **35/** Thus, a private entity's participation in one of the early planning contracts could bar it from participation in subsequent design, construction or operation contracts.

There is a carve-out for registered engineers and land surveyors that may prevent an actionable conflict of interest. **36/**

2. Changes in Use (Demand, Revenue) During Operations Phase

The revenue generated by infrastructure projects can vary from projections. Often the public agency wants to shift this risk to the private entity. To mitigate this risk, PPP agreements may include non-compete clauses.

Another way this risk is mitigated (from the private entity's viewpoint) is for the public entity to either guarantee minimum ridership or pay the private entity for availability regardless of use.

Conclusion

PPPs have the potential to bring infrastructure projects forward in time, but there is no free money. The cost of designing, constructing, operating and maintaining infrastructure projects eventually must be borne by the users or a public entity, and the total cost, even when adjusted to net present value, may well exceed the total cost of conventional government debt financing.

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ENDNOTES

- 1/** See, e.g., Stuart Murray, *Value for Money? Cautionary Lessons about P3s from British Columbia*, Canadian Centre for Policy Alternatives, p. 13 (June 2006).

- 2/ American Institute of Architects and Associated General Contractors of America (2004), *Primer on Project Delivery*, p.4, at www.aia.org/static/state_local_resources/projectdelivery/Project%20%20Delivery%20Primer.pdf.
- 3/ Alameda, Butte, Contra Costa, Del Norte, El Dorado, Fresno, Humboldt, Kings, Los Angeles, Madera, Mariposa, Mendocino, Merced, Monterey, Napa, Orange, Placer, Sacramento, San Diego, San Joaquin, San Luis Obispo, Santa Clara, Shasta, Siskiyou, Solano, Sonoma, Stanislaus, Tulare, Yolo and Yuba counties.
- 4/ Vallejo, Fairfield, Vacaville, Benicia, Suisun City, Dixon, Davis, West Sacramento, Winters, Woodland.
- 5/ *Professional Engineers in California Government v. Department of Transportation*, 13 Cal.App.4th 585 (1993).
- 6/ Statutes 2002, Chapter 688 (AB 1010).
- 7/ Statutes 2006, Chapter 32 (AB 1467).
- 8/ Statutes 2006, Chapter 542 (AB 521).
- 9/ Murray, *supra*, p. 16.
- 10/ January 19, 2008, press release from the Office of the Governor.
- 11/ *Professional Engineers in California Government v. Department of Transportation*, 13 Cal.App.4th 585 (1993).
- 12/ *Graydon v. Pasadena Redevelopment Agency*, 104 Cal.App.3d 631 (1980).
- 13/ *Concerned Citizens Coalition of Stockton v. City of Stockton*, 128 Cal.App.4th 70 (2005).
- 14/ *Zottman v. San Francisco*, 20 Cal. 96 (1862).
- 15/ *Miller v. McKinnon*, 20 Cal.2d 83 (1942).
- 16/ *Walters v. County of Plumas*, 61 Cal.App.3d 460 (1976).
- 17/ Murray, *supra*, p. 19, quoting HM Treasury, *Value for Money Assessment Guide*, p.30 (August 2004).
- 18/ *Golden State Transit Corp. v. City of Los Angeles*, 493 U.S. 103 (1989); *Lusardi Construction Co. v. Aubry*, 1 Cal.4th 976 (1992).
- 19/ *Associated Builders and Contractors v. San Francisco Airports Commission*, 21 Cal.4th 352 (1999).
- 20/ Murray, *supra*, p. 18.
- 21/ Standard & Poor's, *Accounting for Innovation: Treatment of Off-Balance-Sheet Public Sector Financing Operations*, p. 11 (September 23, 2002).



- 22/ 26 USC §103(a) ["gross income does not include interest on any State or local bond"]; California Constitution, Article 13, §26(b) ["Interest on bonds issued by the State or a local government in the State is exempt from taxes on income"]; 42 Ops.Cal.Atty.Gen. 133 ["since the notes are obligations of the State of California, interest thereon would be exempt from the State of California personal income taxes (Const., Art. XIII, §1 3/4) and federal income taxes (26 USC §103, Reg. §1.103-1) under existing laws, regulations and court decisions"].
- 23/ See, e.g., Deloitte, *Closing the Infrastructure Gap: The Role of Public-Private Partnerships*, p. 8 (2005).
- 24/ IRS Revenue Ruling 63-20.
- 25/ Department of Transportation, Federal Highway Administration, *Key Elements of Public Private Partnership ("PPP") Agreements*, Nos. 4 and 9.
- 26/ Murray, *supra*, p. 24.
- 27/ Murray, *supra*, p. 23.
- 28/ Department of Transportation, Federal Highway Administration, *Key Elements of Public Private Partnership ("PPP") Agreements*, No. 22.
- 29/ Murray, *supra*, p. 42.
- 30/ Murray, *supra*, pp. 5, 36.
- 31/ *First Street Plaza Partners v. City of Los Angeles*, 65 Cal.App.4th 650 (1998).
- 32/ *Miller v. McKinnon*, 20 Cal.2d 83 (1942), but see *Marshall v. Pasadena Unified School District*, 119 Cal.App.4th 1241 (2004) [construction company was in no position to know the award of the contract was in contravention of the Public Contract Code, and company was entitled to rely on the acts by public officials in awarding company the contract].
- 33/ *First Street Plaza Partners*, *supra*, 65 Cal.App.4th at 671-72.
- 34/ California Government Code §87100.
- 35/ California Government Code §82048.
- 36/ California Government Code §87100.1.

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**FIRST STREET PLAZA PARTNERS et al., Plaintiffs and Appellants, v. CITY OF
LOS ANGELES, Defendant and Appellant.**

No. B110830.

**COURT OF APPEAL OF CALIFORNIA, SECOND APPELLATE DISTRICT, DI-
VISION TWO**

65 Cal. App. 4th 650; 76 Cal. Rptr. 2d 626; 1998 Cal. App. LEXIS 632; 98 Cal. Daily
Op. Service 5616; 98 Daily Journal DAR 7819

July 16, 1998, Decided

NOTICE: [***1] Opinion certified for partial publi-
cation. *

* Pursuant to California Rules of Court, rules
976(b) and 976.1, this opinion is certified for
publication with the exception of part III.

SUBSEQUENT HISTORY: As Modified on Denial
of Rehearing August 13, 1998, Reported at: 1998 Cal.
App. LEXIS 708. Review Denied September 30, 1998.

PRIOR HISTORY: APPEAL from a judgment of the
Superior Court of the County of Los Angeles. Super. Ct.
No. BC115344. Daniel Curry, Judge.

DISPOSITION: The judgment and order appealed
from are affirmed. Each side to bear its own costs on
appeal.

CASE SUMMARY:

PROCEDURAL POSTURE: Plaintiff partnership chal-
lenged the ruling of the Superior Court of the County of
Los Angeles (California) which granted summary judg-
ment in favor of defendant city in a case concerning a
dispute over a contract.

OVERVIEW: Plaintiff partnership challenged the ruling
of the trial court which granted summary judgment to
defendant city. Plaintiff and defendant negotiated for
several years for a contract to develop a parcel of city-
owned land. In order for defendant to enter into such a
contract with plaintiff, the contract formation rules con-
tained in the city charter had to be followed. Eventually
the defendant decided not to proceed with the project.
Plaintiff then sued and alleged breach of express and
implied contract. The trial court granted summary judg-
ment for defendant. Plaintiff then asserted that a binding
contract was formed when defendant approved a report
from its chief administrative officer (CAO report) detail-

ing the scope and direction of the proposed project. The
court held that the CAO report was not a contract docu-
ment presented for approval by the city council, for ap-
proval as to form by the city attorney, or for signature of
the mayor as required by the city charter. There was no
showing by plaintiff that a contract was formed by the
parties, and the court had no choice but to affirm the de-
cision of the trial court.

OUTCOME: The court affirmed the ruling of the trial
court which granted summary judgment in favor of de-
fendant city when plaintiff did not show that a contract
was formed in compliance with defendant's charter.

SUMMARY:

CALIFORNIA OFFICIAL REPORTS SUMMARY

The trial court granted summary judgment in favor
of defendant city in a development partnership's action
arising from the city's decision not to proceed with a
public project for which plaintiff and the city had en-
gaged in lengthy negotiations that were costly to plain-
tiff. Although no contract had been completed under the
procedural requirements of the city's charter, plaintiff
alleged that a contract was formed when the city ap-
proved a report from its chief administrative officer de-
tailing the scope and direction of the proposed project.
Plaintiff further alleged that the city was equitably es-
topped from denying the formation of a contract. (Supe-
rior Court of Los Angeles County, No. BC115344,
Daniel A. Curry, Judge.)

The Court of Appeal affirmed. The court held that
no contract was formed, since the city did not comply
with the procedural requirements set forth in the city's
charter. The approval of the chief administrative officer's
report did not constitute the formation of a contract. The
court further held that the city was not estopped from
denying the formation of a contract. (Opinion by Ze-
browski, J., with Boren, P. J., and Nott, J., concurring.)

COUNSEL: O'Donnell & Shaeffer, Pierce O'Donnell, Suzanne Tragert, Belynda Reck and Clark Kelso for Plaintiffs and Appellants.

Crowell & Moring, Randall L. Erickson, Donald E. Bradley and Deborah E. Colander as Amici Curiae on behalf of Plaintiffs and Appellants.

Irell & Manella, Steven L. Sloca, Craig Varnen, Harris, Baird, & Abraham, Rita J. Baird and Ansylene A. Abraham for Defendant and Appellant.

Dovel & Associates and Gregory S. Dovel as Amici Curiae.

JUDGES: Opinion by Zebrowski, J., with Boren, P. J., and Nott, J., concurring.

OPINION BY: ZEBROWSKI

OPINION

[*653] [*627] **ZEBROWSKI, J.**

Plaintiff in this case is First Street [***2] Plaza Partners, a limited partnership, and its three corporate members (collectively plaintiff). Defendant is the City of Los Angeles (the City). Plaintiff and defendant negotiated for several years for a contract to develop a parcel of City-owned land. In order for the City to enter into such a contract, the contract formation procedures specified in the City's charter must be followed. Although the parties' negotiations were lengthy and elaborate, the parties never completed the contract formation procedures in the City's charter. Eventually the City decided not to proceed with the project.

Plaintiff then sued. Plaintiff's complaint alleged breach of express and implied contract, estoppel, unjust enrichment and breach of fiduciary duty. The trial court granted summary judgment for the City. On appeal, plaintiff urges two theories. ¹ First, although negotiations were not broken off until 1994, and although proposed contract documents were not completed until 1993, plaintiff asserts that a binding contract was formed when the City approved a report from its CAO (chief administrative officer) in 1991 [*654] detailing the "scope and direction" of the proposed project. Second, [***3] plaintiff asserts that the City is equitably estopped from denying the formation of a contract.

1 Plaintiff's opening brief initially states that plaintiff appeals from the dismissal of its breach of fiduciary duty theory as well as from dismissal of its breach of contract and estoppel theories, but breach of fiduciary duty is not briefed. Plaintiff's

reply brief claims only a right to trial on the breach of contract and estoppel claims. We therefore conclude that plaintiff appeals only on the two theories briefed: breach of contract and estoppel.

Two questions are thus presented on plaintiff's appeal: One, can the provisions of a city's charter (which itemize specific steps necessary for that city to enter into a contract) be satisfied by implication or by procedures different from those specified in the charter? Two, if the requirements of a city's [*628] charter for formation of a contract are not satisfied, can the city nevertheless be equitably estopped from denying that a contract has been formed? Even though [***4] plaintiff presents a case with sympathetic appeal, the legal answer to both of the determinative questions is no. Summary judgment was therefore correctly entered in favor of the City. In the published portion of this opinion, that ruling will be affirmed.

The City has also appealed, contesting the trial court's denial of its motion for attorney's fees. In the unpublished portion of this opinion, that ruling will also be affirmed.

I. FACTUAL AND PROCEDURAL BACKGROUND.

In 1986, the City decided that it needed additional office space for City employees because the City had outgrown City Hall and its annexes and had been housing employees in leased office buildings. In October of 1986, the city council approved a memorandum of understanding between the City and the community redevelopment agency for preparation of a request for proposal (RFP) in response to which private developers would submit proposals to meet the City's objectives. In March of 1987, the City's CAO issued the RFP to qualified developers. The RFP contemplated a project called "First Street North," consisting of an office tower for the City's use plus commercial, residential, community and retail space to be built [***5] on 11 acres of City-owned land located between the civic center and Little Tokyo. In August of 1988, the city council entertained bid proposals from three developers, and subsequently authorized the CAO to enter into exclusive negotiations with plaintiff for development of the site.

During the next several years, the parties engaged in extensive and detailed negotiations. The proposed details of the project varied from time to time, but in general the project called for periodically adjustable ground rent exceeding \$ 1 million per year, a high-rise city office building, over 300 housing units, a hotel with 450-500 rooms, subterranean parking for over 2,000 cars, rehabilitation of the San Pedro Firm Building, a large child care facility, a geriatric counseling center, expansion of

the Japanese American [*655] National Museum, integration of the Temporary Museum of Contemporary Art into the project, a fine arts contribution equal to 1.5 percent of development costs, and other features. The project was expected to be funded by issuance of "certificates of participation"--instruments similar to bonds.

Both the City and plaintiff expended considerable sums negotiating and developing [***6] the project, although plaintiff's expenditures dwarfed those of the City. In its first amended complaint, plaintiff contends that it expended over \$ 12 million in project development costs. This money was spent on tasks such as two environmental impact reports (EIR's), permit procedures, zoning and height district changes, the processing of code amendments to increase the permissible floor/area ratio on the property, a street vacation map, tract maps for subdivision of air rights, and various other land use and environmental review procedures. These procedures were performed in whole or in part while the negotiations were in progress, and consequently in the absence of formal contract documents.

The City contends that plaintiff made these significant expenditures while the negotiations were still in progress because plaintiff insisted on delivery of the property in "buildable" condition within six months after contract. The City claims that it believed that necessary environmental and land use review procedures would take longer than six months, and that it was consequently unwilling to commit to deliver the property in "buildable" condition within six months of contract formation [***7] unless certain environmental and land use approvals were obtained in advance of contract formation. As a consequence, extensive procedures went forward without the formation of a contract in the manner specified in the City's charter, and plaintiff incurred considerable expense. Whatever the cause of these expenses, it is the fact of these expenses, coupled with the eventual termination of the negotiations, which appears to form the primary impetus for this litigation. The controlling law discussed below, however, provides that a chartered city such as the City [**629] cannot incur contract-based liability unless the contract formation provisions of the City's charter are satisfied. The parties' precontract environmental and land use approval activities therefore need not be described in more detail.

The City's charter charges the CAO with keeping the "Mayor and the Council advised of the condition, finances and future needs of the City." In discharge of these duties, and as the negotiations progressed, the CAO periodically reported in writing to the city council on status and developments. One such report, more detailed than the others, was dated August 20, 1991, and was transmitted to [***8] the mayor and city council on August 22, 1991. Plaintiff and two amici curiae, the Associ-

ated General Contractors of California (AGC) and the Building Owners and Managers Association of California (BOMA Cal), contend that this 1991 report (the CAO Report) memorializes the terms of a contract which legally obligated the City to proceed [*656] with the project. The actual wording of the CAO Report, however, disproves this contention.

The heading of the CAO Report notes as its subject "Status Report First Street North Project." It begins with a "Summary," which notes that "Agreement has been reached on most project negotiation issues. However, several issues remain open and require resolution before project documents can be completed. . . . These issues are being discussed with the developer and closure is expected within the next 90 days." THE SUMMARY CONTINUES: "At this time, we recommend that the Council give conceptual approval to the issues negotiated to date and provide resources needed to finalize project documents. Recommendations regarding the remaining open issues will be made to the Mayor and Council within 90 days. [P] A comparison of the Council-directed scope, the [***9] anticipated scope resulting from project negotiations and the status of major deal points is included in Attachment A. Open issues are noted with an asterisk." The Summary proceeds through a report about progress on such matters as the EIR, a general plan amendment, a height district change, zone change, groundwater testing, the appointment of bond counsel, etc., and then states: "Extensive work is now required to complete the detailed project documents. Six major documents will be prepared and delivered for Council review when the final report is forwarded for Council consideration. These include the Master Agreement, the Tower Agreement, the Form of Ground Lease, the Hotel Ground Lease, the Form of Reciprocal Easement Agreement and the Parking Agreement." The Summary then explains that "The City Attorney does not have the staff resources necessary to complete negotiations and draft final legal documents" and that most of the legal work to that date had consequently been done by plaintiff's counsel. The Summary then recommends that "bond counsel's scope of work be extended to include review and redrafting responsibility for the major legal documents for the project." The Summary concludes [***10] with several recommendations, the first of which is "That the Council, subject to the approval of the Mayor . . . Approve the negotiated scope and direction of the First Street North Project as presented in the Addendum to this report and in Attachment A, and authorize the City Administrative Officer to proceed to conclude negotiations, subject to Mayor and Council review of and action on final documents." Additional recommendations relate to financial arrangements necessary to conclude the negotiations.

The "Addendum" to the CAO Report is headed "Status of Project Negotiations," and discusses the history of the project, expected construction costs for the City Office Tower alone of over \$ 100 million, plans to raise funds through certificates of participation issued by the Municipal Improvement Corporation of Los Angeles, the disparity between escalation [*657] in the Los Angeles/Long Beach Consumer Price Index and escalation in building costs, the negotiations with plaintiff regarding an "appropriate method of escalating base building costs," and other financial considerations. The Addendum notes that "Because of the fixed-price nature of the contract, extra care has been [***11] taken in defining what should be included in the building specifications. The City Office Tower building specifications are still [**630] under discussion." The Addendum discusses the details of the long-term (99-year) ground leases contemplated, projected related costs, etc. It explains how a newly imposed requirement for conversion of 20 additional residential units into low-income housing "had a negative effect on the residential portion of the project," and that the City negotiating team had considered "a request by the developer to offset this negative effect by adding office space to Tower B." The Addendum notes that the amount of additional office space necessary "will be adjusted, if necessary, as final budget and financial figures are received by the developer" and that the "results are to be submitted to Mayor and City Council for approval." Regarding the proposed hotel on the site, the Addendum states that "Completion of negotiations for the hotel portion of the project remains open pending review of the Hotel proposal by the City's financial consultant and completion of negotiations with respect to the hotel ground rent." The Addendum continues to note other open issues, such as [***12] the allocation of costs of off-site improvements, the need to identify the amount of certain fees "prior to consideration of the final project documents," and the need for the council to consider amendments to certain ordinances when considering the "final project documents."

Attachment A to the CAO Report is in chart form and compares the specifications of the RFP with the "current position(s)" of the negotiations. The "status" of these various issues is then noted in a final column, with some entries reading "negotiated," some reading "agreed in concept," others stating "open," and others noting specific details awaiting resolution.

On November 13, 1991, the city council adopted a resolution approving, and forwarding to the mayor for his approval, "the negotiated scope and direction of the First Street North Project as presented in the CAO report" and authorizing "the CAO to proceed to conclude negotiations, subject to Mayor and Council review of and action on final documents." Following the adoption of

this resolution, there was some celebrating among city council members, members of the CAO's staff, and negotiators for the plaintiff. Plaintiff emphasizes these events, and they [***13] do suggest that those concerned expected the project to go forward. The contemporaneous expectations of those involved, however, are not germane to the question of whether the requirements of the City's charter had been satisfied and, as discussed [*658] below, the law provides that the City cannot be bound to a contract by estoppel. The details of the celebrating therefore need not be set forth in more detail.

On November 20, 1991, the acting mayor sent a letter to the city council concurring in the council's resolution and approving "the negotiated scope and direction of the First Street North Project as presented in the City Administrative Officer's (CAO) report dated August 20, 1991," and authorizing "the CAO to proceed to conclude negotiations." ² Following these events, plaintiff expended additional sums to prepare and to process a second EIR, an amendment to the general plan, variances, a zoning consistency ordinance amendment, conditional use permits, a street vacation map, tract maps, etc.

2 Plaintiff's briefs state that "Mayor Bradley" acted as though there was a binding contract between plaintiff and the City. However, the letter concurring in the city council's approval of the "scope and direction" of the negotiations and authorizing the CAO "to conclude the negotiations" was signed by Acting Mayor John Ferraro.

[***14] In 1993, the city council was presented with a new economic evaluation of the project and potential alternatives in view of then depressed market rates for office space in downtown Los Angeles. The council consequently began a reevaluation of the proposed project. Work had concurrently been continuing on preparation of the "final report" and "final documents" projected in the CAO Report. These final documents were eventually presented to the city council on October 6, 1994. The council then decided not to go forward and rejected the proposed contract documents. After unsuccessful efforts to negotiate a scaled-down version of the project, the City terminated negotiations with plaintiff. This lawsuit followed.

[**631] Plaintiff's first amended complaint (FAC), after generally alleging the nature and history of the negotiations along the lines set forth above, contains sections entitled "Politics Intervene and the City Does an About-Face," "Mayor Riordan Wields the Ax," and "The City Council Gets in Line Behind the Mayor." These sections allege that immediately after taking office and "primarily for reasons of partisan politics," Mayor Riordan "and his henchmen" began a campaign to "discredit" [***15] the project and "to get rid of" plaintiff.

The FAC alleges that the mayor publicly announced his opposition to the project and recommended termination of negotiations with plaintiff because the Mayor believed that, in view of the contemporaneous condition of the real estate market, the City could lease better and cheaper office space. The FAC alleges that Mayor Riordan was misinformed and [*659] incorrect in this analysis, but that he nevertheless convinced then Councilmember Yaroslavsky--a key councilmember because he chaired the budget and finance committee--of the merits of this view. ³ Negotiations were then conducted with a view to scaling down the project, but these negotiations failed, setting the stage for the council's vote to terminate negotiations with plaintiff. Plaintiff claims out-of-pocket expenditures of over \$ 12 million and total damages of over \$ 26 million.

3 At oral argument, plaintiff argued in support of its estoppel theory that the City had saved millions of dollars by not going forward with the project.

[***16] The trial court granted the City's motion for summary judgment on the grounds that the contract formation requirements of the City's charter had not been satisfied, and that under these circumstances the City could not be bound to a contract by estoppel.

II. DISCUSSION AS TO PLAINTIFF'S APPEAL

a. *Standard of review.*

(1) " [HN1]Summary judgment is granted when there is no triable issue as to any material fact and the moving party is entitled to judgment as a matter of law. ([Code Civ. Proc.], § 437c, subd. (c).) We review the trial court's decision to grant [defendant] summary judgment de novo.' [Citation.] We are governed by the 1993 amendments to Code of Civil Procedure section 437c; [defendant's] burden 'could be met only by showing "that one or more elements of the cause of action . . . cannot be established, or that there is a complete defense to that cause of action." (§ 437c, subd. (o)(2).) Once the defendant has met that burden, the burden shifts to the plaintiff to show "that a triable issue of one or more material facts exists as to that cause of action . . ." ' [Citation.]" (*Lopez v. Superior Court* (1996) 45 Cal. App. 4th 705, 713 [52 Cal. Rptr. [***17] 2d 821].) The reviewing court conducts a de novo examination to see whether the moving party is entitled to summary judgment as a matter of law or whether there are any genuine issues of material fact. (*Mata v. City of Los Angeles* (1993) 20 Cal. App. 4th 141, 147 [24 Cal. Rptr. 2d 314].)

In this case none of the facts relevant to determination of the motion for summary judgment are disputed.

The task, therefore, is to determine, de novo, whether plaintiff's claims lack merit as a matter of law.

b. *Chartered cities versus general law cities: chartered cities have control over "municipal affairs."*

(2a) [HN2]State statutes generally specify the powers possessed by California cities. (cf. Cal. Const., art. XI, § 2, subd. (a).) The California Constitution, [*660] however, authorizes a city to adopt a city charter (Cal. Const., art. XI, § 3, subd. (a)), and hence become a "chartered city." (See Gov. Code, § 34101, 34450 et seq.) The Government Code consequently classifies cities as either "chartered cities" or "general law cities." ⁴ (Gov. Code, § 34101, 34102; see, e.g., *South Bay Senior Housing Corp. v. City of Hawthorne* (1997) 56 Cal. App. 4th 1231, 1235-1236 [66 [***18] Cal. Rptr. 2d 99].) General law cities are those that have not adopted a charter. Such cities remain subject to state [*632] statutes. (See, e.g., *South Bay Senior Housing Corp.*, *supra*, 56 Cal. App. 4th 1231 [general law city must comply with state statute specifying requirements for entering into contract].) ⁵

4 A third possible category consists of cities organized before the adoption of the California Constitution in 1879 which have not chosen to change their form of organization. (*Kennedy v. Miller* (1893) 97 Cal. 429, 433 [32 P. 558]; cf. Gov. Code, § 34400 et seq.)

5 [HN3]A county may also adopt a charter. (Cal. Const., art. XI, § 3, subd. (a).)

A city that has adopted a charter also remains subject to state statutes, except with regard to "municipal affairs" governed by the charter. (Cal. Const., art. XI, § 5.) The purpose of adopting a city charter is to move control over "municipal affairs" from the state legislature to the local government. When a city adopts a charter, state [***19] statutes are generally displaced as to "municipal affairs" covered by the charter. ⁶ Such "municipal affairs" are then " 'unaffected by general laws on the same subject matters.' " (*City of Santa Monica v. Grubb* (1966) 245 Cal. App. 2d 718, 724 [54 Cal. Rptr. 210], quoting *City of Roseville v. Terry* (1958) 158 Cal. App. 2d 75, 76 [322 P.2d 44]; cf. Cal. Const., art. XI, § 5 [allowing "city charter to provide that the city governed thereunder may make and enforce all ordinances and regulations in respect to municipal affairs . . .".])

6 With some possible exceptions not relevant here. (See, e.g., *Tri County Apartment Assn. v. City of Mountain View* (1987) 196 Cal. App. 3d 1283, 1293, 1298 [242 Cal. Rptr. 438] [timing of landlord-tenant transactions a matter of statewide concern governed wholly by state law notwithstanding that subject might be characterized as a

municipal affair[.]) State law on matters of statewide concern has also been found to take precedence in some other circumstances. (See, e.g., *Professional Fire Fighters, Inc. v. City of Los Angeles* (1963) 60 Cal. 2d 276, 292-295 [32 Cal. Rptr. 830, 384 P.2d 158] ["labor relations" a matter of statewide concern, state law may impinge "to a limited extent" on a city's "right to manage and control its fire departments"]; *Dairy Belle Farms v. Brock* (1950) 97 Cal. App. 2d 146, 151-158 [217 P.2d 704] ["statewide policy of milk price stabilization" and "proper regulation of the milk industry" are matters of statewide concern taking precedence over "the awarding of contracts" by "charter provisions for sealed bids"].)

[**20] [HN4]

The constitutional provision authorizing the shift of control over "municipal affairs" from the state to a local municipality by the local municipality's adoption of a charter has been called the "home rule" provision (see, e.g., *City of Los Angeles v. State of California* (1982) 138 Cal. App. 3d 526, 532 [187 Cal. Rptr. 893]), and a city charter "has . . . been aptly termed the local constitution of the city." (*In re Pfahler* (1906) 150 Cal. 71, 82 [88 P. [*661] 270]; see also *Domar Electric, Inc. v. City of Los Angeles* (1994) 9 Cal. 4th 161, 170 [36 Cal. Rptr. 2d 521, 885 P.2d 934] [cardinal principle is that charter is the supreme law of the city, subject only to constitutional limitations and preemptive state law].)

c. *The City's charter controls "municipal affairs," which includes the formation of City contracts.*

(3a) [HN5]The City is a chartered city with maximum allowable control over municipal affairs. (L.A. City Charter, art. I, § 2(4) [tracking language of Cal. Const., art. XI, § 5]; 2(8) [authorizing City to "exercise the fullest measure of local self-government not in conflict with the Constitution and laws of the State of California"]; see [***21] also *Murphy v. City of Piedmont* (1936) 17 Cal. App. 2d 569, 572 [62 P.2d 614] [applying provisions of former Cal. Const., art. XI, § 6, now found in § 5; holding city may avail itself of constitutional privilege of freeing itself from state control over municipal affairs by an express declaration in a city charter].) (2b) The term "municipal affairs" has no exact definition. Instead, the question of whether a particular matter is a "municipal affair" must "be determined upon the facts and circumstances surrounding a given case." (*City of Los Angeles v. State of California, supra*, 138 Cal. App. 3d 526, 532; see also *Southern Pacific Pipe Lines, Inc. v. City of Long Beach* (1988) 204 Cal. App. 3d 660, 668 [251 Cal. Rptr. 411] [because Constitution does not define "municipal affairs," the court must decide under the facts of each

case whether the subject matter at issue is a municipal affair or a matter of statewide concern].)

(3b) [HN6]It was long ago decided, however, that the manner in which a city is empowered to form a contract is generally a "municipal affair" which can be controlled by the terms of its charter. (See, e.g., *Loop Lumber Co. v. Van Loben Sels* (1916) [***22] 173 Cal. 228, 232 [159 P. 600] [the making of contracts for public improvements is a "municipal affair"]; [**633] cf. *Domar Electric, Inc. v. City of Los Angeles, supra*, 9 Cal. 4th 161, 170-171 [expenditure of public funds on public works is a municipal affair].) Thus if a city charter specifies the manner in which that city may enter into a contract, the terms of the charter control over otherwise applicable state law. (*Dairy Belle Farms v. Brock, supra*, 97 Cal. App. 2d 146, 155 [generally, manner of letting contracts is a municipal affair as to which a "home rule" charter is superior to general law]; *Loop Lumber, supra*, 173 Cal. 228, 232 [when charter makes provision regarding a municipal affair, it is the supreme law, paramount to any law enacted by the state Legislature; this proposition has been so often stated "as to have become practically elementary"].)

[HN7]The Charter of the City of Los Angeles contains a section which generally specifies the procedures according to which the City may be bound to a [*662] contract. (L.A. City Charter, art. XXVIII, § 385 (Section 385).) A related section specifies that any contract calling for the receipt or payment [***23] of money for a period of more than three years must be approved by the city council. (L.A. City Charter, art. XXVIII, § 390 (Section 390).) The manner in which the City may be bound to a contract is therefore controlled by the terms of its charter.

d. *Section 385.*

In 1991, at the time of the CAO report, which plaintiff contends was accepted by the city council and mayor as a contract, Section 385 provided in pertinent part as follows: "Every contract involving an expenditure of more than five hundred dollars (\$ 500) shall . . . be made in writing, the draft whereof shall be approved by the board, officer or employee authorized to make the same, and signed on behalf of the City by the Mayor, or some other person authorized thereto by resolution of the Council in the case of a contract authorized by Council, or, in the case of other contracts, by the board, officer or employee, as the case may be, authorized to make the same, provided, however, that the approval of the City Attorney of any such contract as to form . . . shall be endorsed thereon before the Council or such board, officer or employment [sic] shall have the power to approve the same." 7

7 Section 385 has since been reworded somewhat. The effect of that rewording is not involved on this appeal.

[***24] The language of Section 385 is mandatory ("shall"), and plaintiff's briefing agrees that four requirements are specified: "(1) a writing containing all material terms of the [proposed project], (2) approved by the City Council, * (3) signed by the Mayor with (4) the City Attorney's approval as to form" Plaintiff and the two amici curiae contend, however, that these four requirements were satisfied "by the City's adoption of the 35-page, single-spaced CAO Report in November 1991."

8 To the extent that this requirement may be considered not found in Section 385, it is in any event supplied by Section 390, which requires city council approval for any contract calling for the receipt or payment of money for a period longer than three years.

e. The requirements of Sections 385 and 390 were not satisfied by the CAO Report.

[HN8] Even though the provisions of a city charter displace state statutes which would otherwise be applicable to municipal affairs, "[t]he provisions of a charter are the law [***25] of the State and have the force and effect of legislative enactments." (Cal. Const., art. XI, § 3, subd. (a).) (4) As laws of the state, charter provisions are interpreted according to the normal rules of [*663] statutory construction. (See, e.g., *United Assn. of Journeymen v. City and County of San Francisco* (1995) 32 Cal. App. 4th 751, 760 [38 Cal. Rptr. 2d 280] ["[HN9] Generally, the same principles of construction applicable to statutes apply to the interpretation of municipal charters." (Collecting cases discussing principle.)]) In construing a charter, the objective is to determine legislative intent, and the prime determinant is the plain meaning of the language of the charter. "Where the words of the charter are clear, we may not add to or alter them to accomplish a purpose that does not appear on the face of the charter or from its legislative [**634] history." (*Domar Electric, Inc. v. City of Los Angeles, supra*, 9 Cal. 4th 161, 172.)

(3c) [HN10] The Charter of the City of Los Angeles plainly mandates that a city contract of the type involved here must be signed by the mayor, be approved by the city council, and be approved as to form by the city attorney. ⁹ It does this by [***26] using the classic mandatory verb "shall." However, amicus curiae BOMA Cal, and plaintiff in its reply brief, raise an issue of legislative interpretation, to which the City has replied. The argument is that prior to 1911, the predecessor to Section 385 was structured a bit differently. It was then a long and rambling paragraph which stated that the City "shall not

be, and is not bound by a contract . . . unless . . ." the city council publishes a notice, the contract is let to the lowest bidder, etc., followed by a series of "provided that" clauses regarding approval by the city council, signature by the mayor, approval as to form by the city attorney, etc. In 1911, this predecessor section was simplified by breaking out the bidding provisions and placing them into a new section (now Los Angeles City Charter, article XXVIII, section 386), and by restructuring the general contract formation requirements (now found in Section 385) into the present "shall be in writing, approved, signed, etc." form. The record contains no legislative history, evidence or authority indicating that the purpose of the 1911 amendment was anything other than to clarify and simplify the charter by stating the [***27] bidding requirements separately from the general contract formation requirements. Plaintiff and BOMA Cal nevertheless argue that the 1911 amendment establishes that current Section 385 is permissive only. This argument for a permissive-only construction cannot be accepted, for it is directly contrary to the plainly mandatory language ("shall") of Section 385. (See, e.g., *People v. Knowles* (1950) 35 Cal. 2d 175, 181 [217 P.2d 1] [court cannot impute a meaning to a statute not rationally supported by its wording]; *Bruce M. v. Superior Court* (1969) 270 Cal. App. 2d 566, 573 [75 Cal. Rptr. 881] ["shall" is mandatory].)

9 Plaintiff argues that the requirement that the city attorney approve as to form should not be construed to allow the city attorney to "veto" a contract approved by the city council and signed by the mayor, simply by refusing to approve the contract as to form. Whether or not this is correct, it is not an issue raised by the facts of this case.

[*664] As the facts recited above [***28] show, none of the acts which "shall" be done to form a contract with the City ever occurred. The CAO Report on its face was not a contract document presented for approval by the city council, approval as to form by the city attorney, or signature by the mayor. The city council and acting mayor approved only the "negotiated scope and direction" of the project as presented in the CAO Report, and expressly authorized further negotiations reported as necessary to finalize proposed contract documents. The CAO Report itself expressly states that "several issues remain open and require resolution before project documents can be completed," asks for funding to complete the contract documents, and advises the city council and mayor that they will later be presented with final contract documents for approval. The presentation of the CAO Report, and the approvals by the acting mayor and city council of the "scope and direction" reported in the CAO Report, did not constitute contract formation pursuant to Section 385 and Section 390 of the City's charter. ¹⁰

When the mayor and city [**635] council were presented with the actual contract documents, they rejected them.

10 Plaintiff also argues that, despite its mandatory language ("shall"), the requirements of Section 385 need not be satisfied because the City's charter does not expressly *forbid* contract formation in a manner other than as specified in the charter. This proposition is suspect on its face since to accept it would render the contract formation requirements of section 385 a complete nullity. In support of its proposition, plaintiff relies on *Domar Electric, Inc. v. City of Los Angeles*, *supra*, 9 Cal. 4th 161. *Domar Electric* concerned Section 386 of the City's charter, which generally requires the award of certain contracts to the lowest bidder. The question in *Domar* was whether the City could include in its bid specifications a requirement that a bidder engage in certain "outreach" measures to ensure widespread participation in subcontracting. The plaintiff in *Domar Electric* had submitted the lowest bid, but had failed to satisfy the outreach requirements in the bid specifications. Its bid consequently did not conform to the bid specifications, and was rejected for that reason. The court found the City's enforcement of the outreach requirements by rejecting nonconforming bids was permissible under the City's charter. *Domar's* decision about what requirements could properly be placed into bid specifications has no application in the instant circumstances.

Plaintiff also misapplies *Domar's* statements that charter provisions must be construed in favor of municipal power. (See, e.g., *Domar Electric, Inc. v. City of Los Angeles*, *supra*, 9 Cal. 4th at p. 171 ["Charter provisions are construed in favor of the exercise of the power over municipal affairs and 'against the existence of any limitation or restriction thereon which is not expressly stated in the charter' [Citations.] Thus, '[r]estrictions on a charter city's power may not be implied.' "].) [HN11]The issue in construing a charter is generally whether the charter has successfully effected "home rule" regarding a topic, and has thus displaced the "general law" which would otherwise apply. It is in this sense that a charter must be construed in favor of municipal power. The discussions of this concept, found in *Domar* and elsewhere, do not mean that a city's charter must be construed to give the city the "municipal power" to act in disregard of its own charter. To the contrary, *Domar* expressly states that "it is well settled that a charter city may not act in con-

flict with its charter" and that "[a]ny act that is violative of or not in compliance with the charter is void." (*Ibid.*) While it may be true that allowing a city to act in disregard of its own charter would, in one sense, give that city "more power," that is not the point of the discussions in *Domar* and elsewhere about "home rule" power over "municipal affairs."

[***29] [*665] f. *Dynamic Ind. Co. and related cases.*

The decision in *Dynamic Ind. Co. v. City of Long Beach* (1958) 159 Cal. App. 2d 294 [323 P.2d 768] is close to, if not wholly, dispositive of plaintiff's claim that the CAO Report formed a contract between plaintiff and the City. The plaintiff in *Dynamic Ind. Co.* was an oil company. In 1941, the oil company made an offer to Long Beach to recover oil and gas beneath city-owned tidelands over a 35-year period. Title to these tidelands had been granted to Long Beach by the state. The oil company's offer was in the form of a detailed agreement calling for Long Beach to engage the oil company as an independent contractor. Upon receiving the offer, the Long Beach City Council adopted a resolution authorizing the employment of geological and petroleum engineering consultants to examine the proposal. At the request of Long Beach, the oil company paid the cost of these consultants. After the consultants reported favorably on the proposal, the Long Beach City Council authorized negotiations. The city attorney and city manager then agreed on a draft contract, which was presented to the Long Beach City Council in 1942.

The draft [***30] contract was "verbally identical" to the offer originally presented by the oil company, but had each paragraph typed on a separate page "to facilitate revision" and "many of the pages were left partially blank." (*Dynamic Ind. Co. v. City of Long Beach*, *supra*, 159 Cal. App. 2d at p. 296.) "The draft was read at a regular meeting of the Long Beach City Council . . . and approved, paragraph by paragraph, as so read." (*Ibid.*) The city council then adopted a resolution " 'that the City of Long Beach accept said proposal and the City Attorney be, and he is hereby authorized and directed to prepare a proper form of contract [presumably consolidating the paragraphs and deleting the blank spaces] conforming to the plan and methods proposed by Dynamic Industries Company for the development of said submerged lands. The City Attorney is further authorized and directed to prepare said contract and submit the same to the City Council as soon as possible after this adoption date of this resolution.' " (*Ibid.*)

At approximately the same time, the Long Beach City Council directed the city attorney "to settle the exact boundaries of the lands to be developed under the con-

tract." ([***31] *Dynamic Ind. Co. v. City of Long Beach, supra*, 159 Cal. App. 2d at p. 297.) The city attorney was unable to accomplish this task, because the issue was entangled in a dispute between the United States and the State of California. In 1945, the United States sued California in the United States Supreme Court regarding title to all tidelands along California's coast. This suit indirectly called into question Long Beach's title to the tidelands in question, since Long Beach had received its title by grant from the state. The United States's lawsuit "was determined in favor of the United [*666] States in 1947." (*Ibid.*) In 1950, Congress passed the Submerged Lands Act, by which the United States relinquished to the states the ownership of their respective tidelands and submerged lands. The act was [*636] upheld by the Supreme Court against constitutional attack in 1954.

As a consequence of these events, Long Beach was not in a position to proceed with the contract with the oil company until 1954. Long Beach then declined to enter into the contract. The oil company sued, and alleged substantial expenditures relating to the alleged contract. A demurrer by Long Beach was sustained [***32] without leave to amend, and the oil company appealed.

The oil company contended that the resolution adopted by the Long Beach City Council in 1942, approving the proposed contract verbatim, and directing the city attorney to prepare the contract document in proper form and submit it to the city council as soon as possible, created a binding agreement. Long Beach countered that Long Beach was a chartered city, and that its charter provided that the city was bound by a contract only if it was signed by the city manager. The proposed contract had never been signed by the city manager as required by the charter.

The Court of Appeal ruled for Long Beach, stating: "The contract whose validity [the oil company] seeks to establish was not signed by the city manager, as the charter requires. It could not have been signed since the area to be included was never defined nor approved by the city attorney or the council. It is well settled that when a municipal charter contains an express limitation upon the mode in which the city may contract, the city is bound only by contracts executed in accordance with the charter provisions; in other words, where the statute provides the only mode by [***33] which the power to contract shall be exercised, the mode is the measure of the power." (*Dynamic Ind. Co. v. City of Long Beach, supra* 159 Cal. App. 2d at pp. 298-299.)

The court continued that "[t]he fact that [the oil company] expended a substantial sum in reliance upon the 1942 resolution is immaterial in view of the charter limitation." (*Dynamic Ind. Co. v. City of Long Beach,*

supra, 159 Cal. App. 2d at p. 299.) The court found support in a quote from *Zottman v. San Francisco* (1862) 20 Cal. 96, which itself had quoted a New York decision: "**'It may sometimes seem a hardship upon a contractor that all compensation for work done, etc., should be denied him; but it should be remembered that he, no less than the officers of the [municipal] corporation, when he deals in a matter expressly provided for in the charter, is bound to see to it that the charter is complied with. If he neglect this, or choose to take the hazard, he is a mere volunteer, and suffers only what he ought to have anticipated.'**" (*Dynamic Ind. Co. v. City of Long Beach, supra*, 159 Cal. App. 2d at pp. 299-300.) [*667]

In *Dynamic Ind. Co.*, the Long Beach City Council had [***34] approved the precise, verbatim wording of the proposed contract. Nevertheless, in the absence of the city manager's signature as required by the city's charter, no contract was formed even though the city council had approved the precise contract language. In the instant case, by contrast, the Los Angeles City Council never approved the wording of the contract documents. The city council approved only the "scope and direction" of the negotiations as described in the CAO Report. When presented with actual contract language, the city council rejected the proposed contract. Similar to the lack of the city manager's signature in *Dynamic Ind. Co.*, here the signature of the mayor was lacking. The signature of the acting mayor on a letter approving the "scope and direction" of the negotiations as described in the CAO Report is not the equivalent of the signature of the mayor on a document containing the actual language of the contract. In *Dynamic Ind. Co.*, the city's title to the tidelands was unclear. In the instant case, numerous contractual terms remained undecided. *Dynamic Ind. Co.* clearly shows that no contract was formed in the instant case. (See also *Stratton v. City of Long Beach* (1961) 188 Cal. App. 2d 761, 772-773 [11 Cal. Rptr. 8] [following *Dynamic Ind. Co.*].)

Other cases are similar. In *Los Angeles Dredging Co. v. Long Beach* (1930) 210 Cal. 348, 353 [291 P. 839, 71 A.L.R. 161], the court stated: "[HN12]Certain general principles have become well established with respect to municipal contracts . . . It is . . . settled that the mode of contracting, as prescribed by the municipal charter, is the measure of the power to contract; and a contract made in disregard of the [**637] prescribed mode is unenforceable." (See also *Miller v. McKinnon* (1942) 20 Cal. 2d 83, 88 [124 P.2d 34, 140 A.L.R. 570] [quoting from *Los Angeles Dredging*]; *South Bay Senior Housing Corp. v. City of Hawthorne, supra*, 56 Cal. App. 4th 1231, 1236 [general law city must comply with state statute specifying requirements for entering into contract; cases involving chartered cities apply the law the same way]); *Los*

Angeles Equestrian Center, Inc. v. City of Los Angeles (1993) 17 Cal. App. 4th 432, 449 [21 Cal. Rptr. 2d 313] [claim of implied contract not satisfying charter requirements not enforceable]; *Williams Bros. & Haas v. City & Co.*, [***36] S. F. (1942) 53 Cal. App. 2d 415 [128 P.2d 56] [contract unenforceable for failure to comply with charter provisions]; cf. *Reams v. Cooley* (1915) 171 Cal. 150, 154 [152 P. 293] [where statute prescribes method for school district to enter contract, a contract made otherwise is not binding and doctrine of implied liability has no application].)

g. *The City cannot be estopped to deny the existence of a contract.*

(5) Plaintiff and the two amici curiae alternatively contend that even if the requirements of the charter for contract formation have not been satisfied, the City can be estopped to deny the formation of a contract. The cases [*668] consistently reject this proposition. (See, e.g., *Los Angeles Dredging Co. v. Long Beach, supra*, 210 Cal. 348, 353-354 [municipality cannot be estopped to deny validity of contract made in disregard of prescribed mode; such a contract is void unless an emergency exception applies]; *Miller v. McKinnon, supra*, 20 Cal. 2d 83, 88 [quoting *Los Angeles Dredging*]; *Los Angeles Equestrian Center, Inc. v. City of Los Angeles, supra*, 17 Cal. App. 4th 432, 445, 448-449 [City of Los Angeles cannot be bound [***37] by estoppel to a contract not formed in compliance with Section 385]; *San Francisco Internat. Yachting etc. Group v. City and County of San Francisco* (1992) 9 Cal. App. 4th 672, 683 [12 Cal. Rptr. 2d 25] [claim of "bad faith" by city insufficient to bar City's claim of invalidity of contract when no charter compliance; parties cannot waive charter requirements; when charter expressly states manner for execution of contract, city is bound only by contracts executed in accordance with charter provisions]; *Lundeen Coatings Corp. v. Department of Water & Power* (1991) 232 Cal. App. 3d 816, 831 [283 Cal. Rptr. 551] [requirements of Section 385 cannot be avoided on estoppel theory]; *Dynamic Ind. Co. v. City of Long Beach, supra*, 159 Cal. App. 2d 294, 299 ["When the charter provision has not been complied with, the city may not be held liable in quasi contract, and it will not be estopped to deny the validity of the contract."]; *Stratton v. City of Long Beach, supra*, 188 Cal. App. 2d 761, 773 [quoting *Dynamic Ind. Co.*]; cf. *Reams v. Cooley, supra*, 171 Cal. 150 [where statute specifies manner in which school district may contract, and that [***38] manner is not followed, no implied liability]; *State of California v. Haslett Co.* (1975) 45 Cal. App. 3d 252 [119 Cal. Rptr. 78] [claim of oral promise may not be enforced against state on estoppel theory]; *Seymour v. State of California* (1984) 156 Cal. App. 3d 200 [201 Cal. Rptr. 15] [same].) Additionally, as was made clear in *Dynamic Ind.* and

Zottman, the fact that plaintiff expended funds in the course of its dealings with the City is "immaterial," and cannot support an estoppel. (*Dynamic Ind. Co. v. City of Long Beach, supra*, 159 Cal. App. 2d 294, 299; *Zottman v. San Francisco, supra*, 20 Cal. 96, 104-105.)

Because the cases cited above are all closely on point and all adverse to plaintiff's position, plaintiff attempts to wring an estoppel argument out of *Lentz v. McMahon* (1989) 49 Cal. 3d 393 [261 Cal. Rptr. 310, 777 P.2d 83] and *City of Long Beach v. Mansell* (1970) 3 Cal. 3d 462 [91 Cal. Rptr. 23, 476 P.2d 423]. *Lentz* held that a welfare recipient, defending herself in an administrative proceeding seeking reimbursement of excess payments by a county welfare agency, can assert estoppel because she relied on agency error [***39] or misrepresentation. *City of Long Beach* held that a city's actions can estop it from asserting a claim of title to real estate adverse to purchasers who bought in reliance on city action. In *Lentz*, the court stated: "We have long held . . . that estoppel may be asserted against the government 'where justice and right require it' [citation], and we have applied the doctrine [*669] against government entities in a variety of contexts. At the same [**638] time, our cases recognize the correlative principle that estoppel will not be applied against the government if to do so would effectively nullify 'a strong rule of policy, adopted for the benefit of the public.' " (*Lentz, supra*, at p. 399, fn. omitted). *City of Long Beach* contains an almost verbatim passage. (*City of Long Beach, supra*, at p. 493). The "correlative principle" noted in both *Lentz, supra*, at p. 399, and *City of Long Beach, supra*, at p. 493, (estoppel cannot be invoked to nullify a "strong rule of policy"), and the wealth of case law requiring compliance with the terms of a charter in order to form a contract, eliminate *Lentz* and *City of Long Beach* as possible authority [***40] for the proposition that the contract formation requirements of the city charter may be avoided by estoppel. In an analogous vein, the Supreme Court has recently stated that "it is well settled that a charter city may not act in conflict with its charter . . . [and] [a]ny act that is violative of or not in compliance with the charter is void." (*Domar Electric, Inc. v. City of Los Angeles, supra*, 9 Cal. 4th at p. 171). No case has ever held that a city may be bound to a contract by estoppel. Although *Lentz* and *City of Long Beach* do establish that estoppel can be invoked against a city in certain circumstances, they do not displace the great weight of authority that estoppel cannot create contractual duties where compliance with the charter is lacking.

Amicus curiae AGC, arguing for an estoppel, states: "Charter provisions such as the one set forth in Section 385 spell out the procedure by which a contract may be entered into by the City in order to ensure that expensive decisions are not hastily made. Section 385 creates a

broad base of authority by requiring approval by a number of different individuals. No single individual has absolute authority to bind the [***41] municipality; many parts of the city government must work together. [P] Thus, Section 385 promotes a 'checks and balances' system, the key to which is ensuring that many different individuals are privy to and approve of a contract the City enters." After so cogently stating the apparent purpose of Section 385, AGC nevertheless argues that the City can be bound to a contract by estoppel on the theory that the "checks and balances" system created by Section 385 "to ensure that expensive decisions are not hastily made" were satisfied by the CAO Report. The CAO Report itself refutes this contention. The CAO Report calls for approval of final contract details by the city council and the mayor. A judge's opinion that the abstract purpose of Section 385 was satisfied is not a substitute for the review and approval responsibilities vested by Section 385 in the City's elected political officials.

Even if the law did allow a judge's opinion to substitute for the express requirements of a city charter, there could be no estoppel on the record here. Here the city council and mayor were expressly advised that they would [*670] have the opportunity to review and approve or reject final [***42] contract documents. Those final contract documents would have to provide for details such as the price escalation index applicable to the office building, who would pay for offsite improvements, office building specifications left open in the CAO Report, the final content of the low-income-housing component, the amount of office space to be built, the details of the hotel agreement, and many other details. Neither the mayor nor the city council ever approved final contract documents covering these and many other details under discussion. When proposed documents were presented to the mayor and city council, they exercised their expressly reserved power to review and reject them. **Even though the parties may at one time have been proceeding in an atmosphere of goodwill and even camaraderie, and may have held high and even reasonable hopes for eventual formation of a final contract, the record shows that no contract had yet been concluded** and that final contract formation depended on discretionary approval by the mayor and city council. Thus even if a declaration of estoppel were legally permissible, and even if a court were to conclude that plaintiff was shabbily treated, [**639] there is no [***43] basis for an estoppel in the record.

h. The effect of this legal regime is a matter for management by political authorities, not by the courts.

Plaintiff and amici curiae allege that trust in government is currently low, and that to allow the City to "escape liability" based on the "hypertechnicalities" of charter provisions would discourage private parties from

negotiating for contracts with the City, thus reducing competition for city contracts, driving up the City's costs, and harming the City's interests. This might conceivably happen. However, these are not new considerations. For example, *Zottman v. San Francisco*, *supra*, 20 Cal. 96, was an 1862 case concerning events which had occurred in 1854. San Francisco had entered into a contract for construction of an iron fence with a wooden base surrounding a city square. After the contract was formed in accordance with the city charter, certain councilmembers, the city attorney, and other highly placed city officials decided that the fence ought to have a stone rather than a wooden base, and that the iron fence ought to be painted. They instructed the contractor to install a stone base and to paint the fence, and assured [***44] him that the city would pay for the extra work. The contractor did the work, but later was not paid. He sued.

The trial court granted a nonsuit on the grounds that the city charter required that contracts for city improvements be made by ordinance enacted by the common council. The testimony showed that "all the members of the Common Council must have been aware of the order to the contractors, as [*671] the work was in full view from the windows of Council chambers, and was the subject of general conversation and approval by the members at their various sessions and elsewhere, and no opposition to it was ever expressed by any member." (*Zottman v. San Francisco*, *supra*, 20 Cal. 96, 99.) The Supreme Court nevertheless affirmed, stating: "The rule is general and applies to the corporate authorities of all municipal bodies; where the mode in which their power on any given subject can be exercised is prescribed by their charter, the mode must be followed." (*Id.* at p. 102.) Since the contract for the extra work had not been formed in accordance with the requirements of the city charter, the Supreme Court ruled that there was no enforceable contract and that the contractor [***45] had no right to payment for the extra work.

As authority for the general proposition that a fictitious legal entity (such as a city), which has its powers specified in its creating document (such as a city charter), cannot be bound other than as specified in that document, the *Zottman* court cited an 1804 United States Supreme Court ruling. In the 1804 case, Chief Justice Marshall ruled that an unauthorized employee of a corporation could not bind the corporation to a contract except in the manner specified in the corporation's enabling act. (*Head & Amory v. The Providence Insurance Company* (1804) 6 U.S. 127 [2 L. Ed. 229].) **Thus the proposition that a contract with a city is not binding unless formed in accordance with the city charter has been in place in California at least since the time of the Civil War, and is based on analogous authority traceable back to Chief Justice Marshall.**

11 *Head & Amory* did not involve issues of estoppel or ostensible authority, and the law of corporations was somewhat different at the time. The Supreme Court, however, cited this 1804 case as authority for the analogous proposition involved in *Zottman*.

[**46] Perhaps it is true, as plaintiff and amici curiae argue, that this long-standing state of law could dampen the willingness of private parties to deal with the City on major projects, but that is a matter for management by the City's political authorities. Judges may not properly intrude here on no sounder footing than the varying opinions of different judges about what ought to be done. Methods are available to change this situation by amending the city charter should it be concluded that operating according to the charter is harmful to the City's best interests. **The instant case seems largely the product of size and complexity coupled with the modern phenomenon of "public-private partnerships." Given the current terms of the charter, it may be that "public-private" projects of this magnitude can only be safely undertaken by a sequence of contracts, with each successive [**640] contract protecting a party**

in plaintiff's position, or by a contract containing conditions subsequent or dispute resolution methods by which undecided issues will later be decided. These approaches might be cumbersome, but the alternative [*672] is the course followed here: extensive expenditure before contract [47] resulting in exposure to significant loss in the event of ultimate failure of the contract negotiations.**

III. DISCUSSION AS TO THE CITY'S APPEAL. *

* See footnote, *ante*, page 650.

IV. DISPOSITION.

The judgment and order appealed from are affirmed. Each side to bear its own costs on appeal.

Boren, P. J., and Nott, J., concurred.

A petition for a rehearing was denied August 13, 1998, and the opinion was modified to read as printed above. The petition of plaintiffs and appellants for review by the Supreme Court was denied September 30, 1998.