Appeal of FRANCIS GEHL, LOIS GEHL, BARBARA O'BRIEN and ANN PRICE from action of the Board of Education of the City School District of the City of Corning and the Corning-Painted Post High School Development Corporation regarding the approval of certain agreements.

Decision No. 14,857

(April 1, 2003)

Sayles & Evans, attorneys for respondent board, James F. Young, Esq., of counsel

Devorsetz Stinziano Gilberti Heintz & Smith, P.C., attorneys for respondent development corporation, Kevin G. Roe, Esq., of counsel

MILLS, Commissioner.--Petitioners challenge the approval by the Board of Education of the City School District of the City of Corning ("respondent board") of a "Lease Agreement" and "Agency Agreement" (the "agreements") with the Corning-Painted Post High School Development Corporation ("respondent development corporation"). The appeal must be sustained in part.

In July 2000, a district facilities study committee presented a plan known as "Option 2" to respondent board. Option 2 included, among other things, the construction of a new high school on property then owned by the Town of Erwin, the transfer of students from two of the district's middle schools to the two existing high schools, the conversion of one middle school to an elementary school and the sale of the other. The plan called for the Town of Erwin to create a local development corporation to build the high school and lease it to the district for 30 years. Construction would be financed by the sale of bonds issued by the development corporation as well as a pledge from Corning Incorporated ("Corning"), the area's largest employer, to contribute a maximum of two million dollars per year for 30 years to cover the portion of project costs not covered by state building aid.

At a special meeting on June 19, 2001, 58% of the voters approved a proposition nearly identical to Option 2 authorizing reconstruction of various school buildings, the issuance of bonds to finance the reconstruction, the execution of "a lease for up to thirty (30) years for a new high school at a maximum annual cost not to exceed $5,500,000 (such costs offset by state aid and contributions)" and the sale of "the Northside Blodgett Middle School for housing use for not less than $1,000,000...."

In November 2001, the Town of Erwin incorporated respondent development corporation to acquire the property for the high school, construct the facility, lease it to the district, and issue bonds to finance the project. The development corporation's certificate of incorporation establishes a five-member board of directors comprised

of respondent board's president, the superintendent of schools, a district business official, a member appointed by the supervisor of the Town of Erwin and a member appointed by Corning. Respondent development corporation contracted with an architectural firm to design the high school and submit the plans to the State Education Department for approval, and hired a construction manager. It also obtained a $7,000,000 interest-free loan from Corning to cover costs incurred in advance of the issuance of bonds.

On December 5, 2001, respondent board approved an "Agency Agreement" in which it agreed to act as the development corporation's agent for the administration of the contracts related to the design and construction of the high school. Respondent board also approved a "Lease Agreement" specifying the rights and obligations of the parties with respect to the construction and lease of the high school. The "Lease Agreement" states that lease payments shall "equal the annual debt service payments required under the Indenture with respect to the Bonds (which amounts shall not in any event exceed $5,500,000 annually)." It further provides that "[u]pon issuance of the Bonds the District and the Corporation agree to amend this Lease Agreement to incorporate such payment dates and amounts."

Petitioners challenge the legality of the agreements. Petitioners argue that because certain penalty provisions obligate the district financially beyond the payment of periodic rent as it comes due, the "Lease Agreement" constitutes debt. They further allege that Local Finance Law §20.00 does not authorize this form of debt. Petitioners also contend that the "Lease Agreement" violates Local Finance Law §104.00, which limits the amount of indebtedness for which a city school district may contract to no more than five percent of the average full valuation of the school district, unless, among other things, the debt is approved by 60 percent of voters at an election, and both the Board of Regents and the Comptroller consent to the arrangement.

Petitioners contend that pursuant to the Agency Agreement, respondent board has improperly transferred its rights and powers to respondent development corporation and has improperly bound itself to legislate in a particular way. Petitioners request, among other things, that I invalidate the agreements.

Respondent board contends that the appeal is premature because the "Lease Agreement" has not been approved by the Commissioner of Education pursuant to Education Law §403-b, and is "subject to revision." Respondent board also contends that petitioners have improperly raised new claims in both their reply and their memorandum of law. Finally, respondent board denies that the agreements are unlawful.

By letter dated November 6, 2002, petitioners were directed to join respondent development corporation as a necessary party pursuant to §275.1 of the Commissioner's regulations. Petitioners promptly did so, serving the verified petition and notice upon respondent development corporation on November 13, 2002. In its answer,

respondent development corporation alleges that its joinder is untimely and barred by the doctrine of laches and asserts that I lack jurisdiction to entertain petitioners' claims. Respondent development corporation also alleges, among other things, that the "Lease Agreement" does not constitute debt of the school district and, therefore, is not subject to the requirements of Local Finance Law §§20.00 and 104.00.

In reply, petitioners allege that the development corporation is not a necessary party, that joinder was timely and that respondent development corporation has not been prejudiced by any delay because it has not yet issued bonds. Petitioners argue that respondent development corporation acted at its own peril when it spent money to prepare for the project because it was on notice that this appeal was pending.

Petitioners have attempted, improperly, to raise new claims in both their reply and memorandum of law. A reply is not meant to buttress allegations in the petition or to add belatedly assertions that should have been in the petition (Appeal of Karpen, 40 Ed Dept Rep 199, Decision No. 14,460; Appeal of Crowley, et al., 39 id. 665, Decision No. 14,345; Appeal of Hollister, 39 id. 109, Decision No. 14,188). Similarly, a memorandum of law may not be used to add new assertions that are not part of the pleadings (Appeal of Grinnell, 37 Ed Dept Rep 504, Decision No. 13,914; Appeal of Coombs, et al., 34 id. 253, Decision No. 13,301; Appeal of the Bd. of Educ., Tuxedo UFSD., 33 id. 626, Decision No. 13,171). Accordingly, while I have reviewed petitioners' reply and memorandum of law, I have not considered those portions that contain new allegations that are not responsive to new material or affirmative defenses in respondents' answer. I also note that on three separate occasions, petitioners have sought permission to submit additional affidavits and exhibits. Additional affidavits and exhibits may only be submitted with the prior permission of the Commissioner (8 NYCRR §276.5). While this provision permits the submission of additional evidence, it cannot be used to add new claims against a respondent for which notice has not been provided (Appeal of Johnson, 38 Ed Dept Rep 524, Decision No. 14,086). I have not accepted these materials because I find that they raise new issues and introduce new exhibits that are not relevant to the claims originally raised in this appeal (Appeal of Johnson, supra; Appeal of Sherman, 36 Ed Dept Rep 168, Decision No. 13,691).

I decline to dismiss the appeal as premature. Respondents have approved and executed the "Lease Agreement" and are, therefore, bound by its terms. Although the "Lease Agreement" does not specify the exact amount of the payments thereunder, it does place an annual cap on them. The agreement also defines the rights and obligations of the parties with respect to the proposed construction of the high school and respondent board's anticipated lease thereof. Further, based on this agreement, respondent development corporation has taken preliminary steps to fulfill its obligation to construct the high school. Moreover, the Agency Agreement is in effect. Under these

circumstances, I find that petitioners' challenge to the agreements presents a ripe controversy.

I also decline to dismiss the appeal for failure to timely join a necessary party. An appeal to the Commissioner of Education pursuant to Education Law §310 must be commenced within 30 days of the action or decision complained of, unless the delay is excused by the Commissioner for good cause shown (8 NYCRR §275.16). Petitioners challenge the legality of the agreements approved by respondent board on December 5, 2001. Petitioners commenced the appeal against respondent board on time. While they did not join respondent development corporation until November 2002, beyond the 30-day period, for the reasons set forth below, that delay does not require the dismissal of this appeal.

The Commissioner may, in his sole discretion, direct joinder of a necessary party (8 NYCRR §275.1). (Contrary to petitioners' assertion, respondent development corporation is a necessary party, because its rights would be adversely affected by a determination in petitioners' favor (Appeal of Olsen, 42 Ed Dept Rep ___, Decision No. 14,761; Appeal of Roff, 41 id. ___, Decision No. 14,708). The Commissioner has exercised his discretion to join a necessary party after the expiration of the 30-day time period for commencing an appeal (see, e.g., Appeal of Heller, 34 Ed Dept Rep 220, Decision No. 13,288; Appeal of Levine, 24 id. 172, Decision No. 11,356; aff'd sub nom Capobianco v. Ambach, 112 AD2d 640). In such cases, the petitioner promptly joined the necessary party after being directed to do so and no prejudice was demonstrated (id.). Here, petitioners promptly joined respondent development corporation once directed to do so.

Although respondent development corporation claims prejudice because it borrowed funds from Corning to pay for preliminary work on the project, there is insufficient evidence of prejudice to warrant dismissal of the appeal. The development corporation has not demonstrated that it will be unable to recoup those funds. Moreover, the important public financing issues presented in this appeal warrant excusing petitioners' late joinder of respondent development corporation.

I also decline to invoke the equitable doctrine of laches to dismiss the appeal. Laches may bar "the enforcement of a right where there has been an unreasonable and inexcusable delay that results in prejudice to a party" (Skrodelis v. Norbergs, 272 AD2d 316). "Prejudice may be established by a showing of injury, change of position, loss of evidence, or some other disadvantage resulting from the delay" (id.). I find that respondent development corporation has failed to establish sufficient prejudice to justify application of the laches doctrine. In the context of public financing and construction projects, courts have invoked the laches doctrine only where a public agency has undertaken concrete, significant and arguably irreversible action (see, e.g., Burns v. Egan, 117 AD2d 38, [laches barred challenge to prison construction financing scheme where State had begun prison construction and had issued bonds];

Matter of General Building Contractors v. Egan, 106 AD2d 688 [laches barred various challenges to bid specifications where contracts had been awarded and the projects challenged were more than 85% complete]). Although respondent development corporation had expended funds on certain preliminary work by the time joinder occurred, actual construction on the high school had not begun and bonds had not yet been issued. Under these circumstances, I decline to invoke the equitable doctrine of laches.

Although the parties characterize the contract between respondent development corporation and respondent board as a "lease," for the reasons set forth below, I find that it is, de facto, a lease-purchase agreement. While Education Law §§2503(8) and 1726 permit a school district to enter into a lease-purchase agreement subject to certain requirements, the agreement at issue does not comply with those requirements. It is, therefore, unauthorized.

The fact that respondents have deemed to call the agreement a "lease" does not make it so. Rather, I must scrutinize the entire agreement to determine the true intent of the parties (Marine Midland Trust Co. v. Village of Waverly, 42 Misc. 2d 704, aff'd 21 AD2d 753; Op. St. Compt. 91-13). State Comptroller's Opinion 91-13 is instructive in this regard. There, the State Comptroller examined whether, among other things, a complex arrangement entered into by a municipality for the purchase of a municipal building was an unlawful lease-purchase agreement. (Although Education Law §1726 authorizes a school district to acquire a building through a lease-purchase agreement if certain requirements are met, neither the General Municipal Law nor the Local Finance Law authorizes a municipality to do so.) One factor considered significant by the State Comptroller was whether the lessor retains meaningful economic elements of ownership, such as the risk of loss and responsibility to maintain the property. Where the lessee assumes those responsibilities during the lease period, support is found for the existence of a lease-purchase agreement.

Also relevant was whether the agreement provided the lessee with any right to take title to the property at the end of the lease period, and on what terms. A provision that gives the lessee the right to purchase the property for a nominal sum at the end of the lease period suggests the existence of a lease-purchase agreement. The Comptroller has cautioned, however, that a transfer of title to the lessee is not essential to find that the parties have entered into a lease-purchase agreement. Even where title does not pass, a lease-purchase agreement may be inferred where the lease extends over the useful life of the property and the lessee assumes the risk of loss and responsibility during the agreement (Op. St. Compt. 91-13).

Applying these principles to the facts here, I find that the "Lease Agreement" constitutes a lease-purchase agreement. During the lease period, respondent development corporation retains few incidents of ownership in the high school. To the contrary, respondent board assumes many of the responsibilities that ordinarily attend ownership. The district is responsible for "making all

necessary repairs and replacements, interior and exterior, structural and non-structural" (§5.01) and paying all utilities and property taxes (§5.02). Further, the agreement authorizes respondent board to "make such additions, enlargements, improvements and expansions to, or repairs, reconstruction and restorations of [the high school]," as it deems necessary or desirable (§5.03). The agreement also requires respondent board to maintain liability insurance, including among other things, builder's risk insurance, comprehensive boiler and machinery insurance, comprehensive general liability insurance and property insurance (§5.05). Further, respondent board assumes the risk that any insurance proceeds may be inadequate to repair, reconstruct or restore the high school (§5.05[e]). These terms burden respondent board with responsibilities that are consistent with an ownership interest in the property.

The fact that respondent board's obligation to pay rent under the lease is unconditional lends further support to the conclusion that respondents intended to enter into a lease-purchase agreement. The agreement provides that the district's obligation to make payments will not be postponed or diminished if construction of the high school is delayed for any reason (§3.01). Similarly, §4.04 of the agreement specifies that the district's obligation to make payments under the lease is "absolute and unconditional," whether or not the high school is used or occupied, or available for use or occupancy by the district.

In Opinion 91-13, the Comptroller found significant the unconditional nature of the municipality's lease payments in concluding that the arrangement there was a lease-purchase agreement. As the Comptroller noted, "...this provision of the lease, which obligates the municipal corporation to pay rent without regard to whether the facility is actually available for its intended purpose, strongly infers that the lease is intended not only to provide the municipal corporation with the use and occupancy of the property, but also to transfer all risks of ownership to the municipal corporation as well" (Op. St. Compt. 91-13). This logic applies with equal force to the agreement here.

The fact that respondent development corporation does not retain any ownership interest in the high school at the end of the lease period (§9.01) also evinces a lease-purchase agreement. Even in the absence of any title transfer, the fact that the 30-year lease term corresponds to the probable usefulness of the building under Local Finance Law §11.00 further suggests that respondents intended to enter into a lease-purchase agreement (Op. St. Compt. 91-13).

Further, the backdrop against which this agreement was drafted strongly suggests that the "Lease Agreement" is not intended as a true lease, but is instead designed to provide a means for respondent development corporation to finance the construction of a new high school to be owned by respondent board. The construction of the high school is part of a plan devised by the district's facilities study committee to address the district's facilities needs. Respondent development corporation was created for the express purpose of

constructing the high school to respondent board's specifications. In short, based on the totality of the circumstances, I find that the "Lease Agreement" is, in fact, a lease-purchase arrangement.

Education Law §2503(8) authorizes a board of education of a city school district to enter into a lease-purchase agreement under the same terms and conditions as a board of education of a union free school district. Education Law §1726 prescribes the terms and conditions under which a board of education of a union free school district may enter into a lease-purchase agreement. In this case, the de facto lease-purchase agreement does not comply with at least two statutory requirements.

First, Education Law §1726(12) requires the school district to "pledge its full faith and credit for the full performance of all obligations under such agreement, including all annual payments required to be made thereunder." Consequently, such obligations constitute "indebtedness" of the district within the meaning of Article VIII of the New York State Constitution. Contrary to statutory requirements, the "Lease Agreement" explicitly states that "[n]either the full faith and credit nor the taxing power of the District are pledged to the payment of any amount due or to become due under this Lease Agreement" (§4.04) and that "[t]he Lease Agreement and the obligations of the District hereunder do not and will not constitute indebtedness of the District under Articles VII or VIII of the State Constitution or Section 20.00 of the Local Finance Law of the State..." (§6.10). Second, Education Law §1726(1) authorizes the lease-purchase of "buildings for school purposes, to be placed or erected on a site owned by the district." Here, the high school is to be constructed not on school district property, but on land owned by respondent development corporation.

Accordingly, on these facts, I find the parties' de facto lease-purchase agreement to be invalid. (I further note that if the payments under any future lease-purchase arrangement cause the district to exceed the constitutional debt limit, approval of 60% of the district voters and the consent of the State Comptroller and the Board of Regents are also required [Local Finance Law §104.00]).

In light of this disposition, I need not address the legality of the Agency Agreement or the parties' remaining contentions.

THE APPEAL IS SUSTAINED TO THE EXTENT INDICATED.

IT IS ORDERED that the "Lease Agreement" between respondent board and respondent development corporation is annulled.

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