

# CLIENT NEWS BRIEF

## Court Rules that Second Contract with the Same Vendor Did Not Create a Conflict of Interest

A recent California Appellate Court ruling has determined that a public entity's award of a second contract to a construction firm did not create a conflict of interest even though it related to an earlier contract between the parties. In *California Taxpayers Action Network v. Taber Construction, Inc.* (2019) A145078, the First Appellate District held that the contractor's second contract with a school district did not create a conflict of interest because both contracts were part of one initial transaction which had been structured as two contracts because applicable law at the time did not permit the transaction to be structured as a single contract. This is the latest chapter in a series of cases about potential conflicts of interest in lease-leaseback construction contracts for school districts, but the ruling has implications for many different types of contracts made by all local public agencies.

### Background

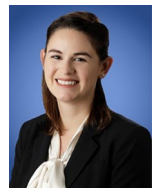
Prior to January 2017, when the Education Code's lease-leaseback statutes were revised, school districts were prohibited from awarding lease-leaseback construction contracts until plans and specifications for the underlying project were approved by the Division of the State Architect ("DSA"). [[Link to CNB re LLB changes in Jan. 2017 – CNB No. 63, 2016](#)] Until those changes took effect, school districts wishing to procure preconstruction services from the contractor who would ultimately perform their lease-leaseback projects commonly entered into a separate contract for such preconstruction services. Mount Diablo Unified School District ("District") selected Taber Construction ("Taber") to perform a modernization project through a request for proposal process and first awarded a preconstruction contract to Taber. After completion of the preconstruction services and approval of the plans and specifications by DSA, the District awarded a lease-leaseback construction contract to Taber.

A taxpayer organization challenged this dual contract structure by alleging a conflict of interest based on the contractor's ability to inappropriately influence the District in the creation of the second contract. In May 2017, an appellate court ruled that the plaintiff's allegations were sufficient to let that issue proceed to trial. [[See CNB No. 23, 2017](#)] That decision agreed with appellate decisions in 2015 and 2016 on similar issues, in which other courts agreed that the preconstruction services contract/lease-leaseback contract structure could lead to violation of Government Code section 1090, which prohibits conflicts of interest in public contracts, because of the contractor's ability to shape the scope of the second contract through their work under the first contract. Based on this reasoning, a conflict of interest could potentially arise whenever a local public agency entered into two successive contracts with the same contractor, if the work performed under the first contract had an impact on the scope of work under the second contract.

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## The Appellate Court's Decision

Following trial on these issues, an appeal once again reached the appellate court, which has now held that when Taber performed the preconstruction services, it was not transacting "on behalf of" the District in violation of Government Code section 1090. The court reasoned that Taber was not hired under the first contract to find a firm to complete the project – rather, the District hired Taber to perform preconstruction services for the District "in anticipation of Taber itself completing" the project. The court reasoned that it was standard practice at the time to award two separate contracts due to the existing lease-leaseback law, and that the District purposefully selected Taber with the initial intent that it would award both contracts to Taber.

The court distinguished an appellate court decision, *Stigall v. City of Taft* (1962) 58 Cal.2d 565, that the plaintiff relied upon which held that a conflict of interest existed under Section 1090. In that case, which arose outside of the lease-leaseback context, there was evidence that a representative of the selected contractor was involved in the selection process. However, the court found no evidence indicating that during performance of the preconstruction services, Taber influenced the District to select Taber for the second contract.

## Takeaways

As noted above, due to revisions that went into effect in January 2017, the lease-leaseback statute (Ed. Code § 17406) now expressly permits a school district to award a single contract that includes preconstruction services and lease-leaseback construction. Therefore, the fact pattern of this case is not likely to recur.

However, similar fact patterns could arise in other contexts, such as architectural contracts for master planning services where the architect may wish to also receive award of a subsequent contract for design of an individual project. Another example might be a vendor who enters a consulting contract with an agency to determine the agency's technology needs, and then is subsequently awarded a contract to supply technology to the agency. In these situations, this case provides guidance as to when a conflict of interest might exist under Section 1090. While initially selecting one firm for both contracts might reduce the chances of a conflict of interest when the second contract is eventually awarded, risk remains if the firm is involved in the shaping the scope of the second contract. If appropriate for the situation, it may be beneficial simply to award a single contract for all of a contractor's or consultant's work, rather than two contracts.

For more information about this ruling and conflict of interest issues, please contact the authors of this Client News Brief or an attorney at one of our [eight offices](#) located statewide. You can also subscribe to our [podcast](#), follow us on [Facebook](#), [Twitter](#) and [LinkedIn](#) or download our [mobile app](#).