DAVIS V. FRESNO UNIFIED SCHOOL DISTRICT
The *CITIZEN'S UNITED* of California Conflicts of Interest Law, or When is a Corporation an "Employee"?

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I INTRODUCTION

California conflict of interest law has long prohibited state and local public officials from exercising their official authority when they have a personal interest in their public actions. Over time, the Legislature and the people of the state codified and refined conflict laws through statutes and initiatives such as Government Code Section 1090 and the Political Reform Act of 1974.[1] As stated in the Attorney General's *Conflicts of Interest Guide,* these laws are "…grounded on the notion that government officials owe paramount loyalty to the public, and that *personal and private considerations on the part of government officials* should not be allowed to enter into the decision-making process." (Emphasis added.)

The notion that the state's conflict of interest laws exist to prevent government officials from participating in public decision-making when they have a private interest in the decision is pretty straightforward when the official is a natural person. However, some interesting questions arise when one considers application of these laws to corporate entities. Can a corporation have a *personal interest* in a public decision? Can a corporation be a public "official" or "employee"?

In *Citizen's United v. Federal Elections Commission* (2010) 558 U.S. 310, the United States Supreme Court declared that "corporations are people, too" when it comes to the First Amendment *right* to make independent expenditures to support political speech. Last June, the California Court of Appeal for the Fifth Appellate District declared that along with legal rights, corporations may also have legal duties. In *Davis v. Fresno Unified School District,* (2015) 237 Cal.App.4th 261*,* the court declared that at least some of the legal obligations imposed by the state's conflict of interest laws apply to corporate entities. That is, under certain circumstances, corporate entities will be considered public "officials" or "employees" prohibited from participating in government decisions when their "personal" interests could be affected by the decision.

[1] The Act is codified at California Government Code Sections 81000 et seq.

II. CASE SUMMARY

The Facts

This case arises out of the approval by the Fresno Unified School District ("FUSD") of two contracts for the construction of a new middle school. The first contract was a lease by which FUSD leased to Harris Construction Company ("HCC") the site of the new school. This contract was referred to as the Site Lease. The second contract, referred to as the Facilities Lease, was a lease of the site and improvements constructed on the site back to the district.

Under the Site Lease, FUSD leased to HCC the property for $1 in rent. The term of the lease began in September 2012, and expired on the same day as the Facilities Lease.

Under the Facilities Lease, HCC promised to build the new school pursuant to "Construction Provisions" that were attached to the lease as an exhibit. HCC also promised to lease the property with the improvements back to FUSD. In return FUSD promised to make lease payments under a Schedule of Lease Payments. The Construction Provisions exhibit was a typical 55 page construction agreement with plans and specifications and a promise by FUSD to pay a guaranteed maximum of $36.7 million dollars. The Schedule of Lease Payments was a reference to progress payments to be paid under the Construction Provisions. The "lease payments" due were based upon the amount of construction accomplished. Under the Facilities Lease, it (and as a consequence the Site Lease) terminated upon completion of the construction of the school and the making of the final "lease payment." Title to the land and improvements would vest in FUSD upon termination of the Facilities lease.

Davis was a taxpayer in the district who was concerned about the lease-leaseback arrangement between FUSD and HCC. Davis maintained that the deal was an illegal attempt to avoid the requirement to competitively bid the school construction project. FUSD argued that the transaction fit within an exception to the competitive bidding requirements provided in Section 17406 of the Education Code. In addition, Davis argued that FUSD's approval of the lease/leaseback contracts violated California conflict of interest laws. Davis asserted that in the efforts leading up to the approval of the leases, HCC had acted as a professional consultant to FUSD, and had participated in developing the plans and specifications for the new middle school. Davis asserted that because of this consulting relationship, state conflicts law prohibited HCC from being awarded a contract that it had a role in developing.

Procedural Status

Davis filed a complaint to invalidate the lease/leaseback contracts between FUSD and HCC. FUSD and HCC demurred to the complaint and the trial court sustained the demurrers. In its order the court gave Davis 30 days to amend his complaint, but he did not do so. After judgment was entered in favor of FUSD and HCC, Davis appealed.

Issues Presented[2]

Because the appeal was taken from the denial of a demurrer, the issues presented were as follows:

[1] Did Davis plead sufficient facts to establish a violation of the Political Reform Act of 1974?

[2] Did Davis plead sufficient facts to establish a violation of California Government Code Section 1090?

[3] Did Davis plead sufficient facts to establish a common law conflict of interest?

The Court's Holding

[1] Davis did not plead sufficient facts to establish a violation of the Political Reform Act of 1974.

Government Code Section 87100 prohibits public officials from making or participating in decisions in which they have a financial interest. In *Davis,* the plaintiff alleged that HCC (the corporate entity, not a specific HCC officer or employee) served as a consultant to FUSD on the middle school project. Thus, the question presented was whether, for the purposes of Section 87100, a corporate entity could be considered a "public official." The court concluded that corporate entities are not "public officials" for the purposes of Section 87100.

The court noted that Government Code Section 82028 defines "public official" as including "every member, officer, employee, or consultant of a state or local government agency." The court also noted that while no statute defined what "consultant" means, the FPPC has adopted a regulation that does. Under Regulation 18704.6,[3] a consultant is defined as "an *individual* who, pursuant to a contract with a state or local government agency…(1) makes a governmental decision…, or (2) …serves in a staff capacity and in that capacity participates in making a governmental activity." (Emphasis added.) The court concluded that since Davis had not named any individual in their complaint, and since, by definition, only individuals are "consultants", Davis had failed to state sufficient facts to establish a violation of the Act.

[2] Davis pled sufficient facts to establish a violation of Government Code Section 1090

California Government Code Section 1090 provides that government "officers and employees shall not be financially interested in any contract made by them in their official capacity." The *Davis* court began its 1090 analysis by addressing the question of whether HCC *made* a contract

[2] The greater part of the appellate court's opinion addresses the Education Code requirements for competitive bidding, and whether the lease/leaseback arrangement fell within the statutory exception. This paper addresses only the conflict of interest issues presented in the case.

[3] This regulation was renumbered to 18700.3 after the *Davis* opinion was published.

in its official capacity. In disposing of this issue, the court cited the longstanding precedent established by the Supreme Court in *Stigall v. City of Taft* (1952) 58 Cal.2d 565. In that case, the court broadly interpreted the concept of "making a contract'" to include not only the act of approving and signing the contract, but also "planning, preliminary discussions, and drawing plans and specifications" engaged in as part of the contracting process.

The court then turned to the question of whether HCC could be considered a government "employee" for the purposes of the 1090 prohibition. The court concluded that at least in the context of a civil action seeking to invalidate a contract, a corporate entity providing consulting services to a public agency could be considered an "employee" of the agency.

In reaching this conclusion the court starts by citing two cases, *California Housing Finance Agency v. Hanover/California Management & Accounting Center, Inc.* (2007) 148 Cal.App.4th 682 and *HUB City Solid Waste Services, Inc. v. City of Compton* (2010) 186 Cal.App.4th 1114, for the proposition that outside consultants may be subject to the 1090 prohibition. The court then noted that both of these cases involved individuals serving as consultants, and not allegations against a corporate entity consultant. Thus, the court determined it was reaching an issue of first impression.

FUSD and HCC argued that Section 1090 should not be extended to consultants for the reasons cited in a case entitled *People v. Christiansen* (2013) 216 Cal.App.4th 1181. In *Christiansen,* a consultant to the Beverly Hills Unified School District was criminally prosecuted and convicted by a jury for violating Section 1090 in connection with a number of school district contracts. In overturning the conviction, the appellate court ruled that Ms. Christiansen could not have been convicted of a 1090 violation, because it was undisputed that she was an independent contractor and not an officer or employee of the District. In reaching its conclusion, the *Christiansen* court criticized the conclusions of the *Hanover* and *Hub City* courts.

The *Davis* court rejected FUSD and HCC's argument. The court opined that *Christiansen* was distinguishable, because it involved a criminal prosecution, and not a civil case brought to invalidate a public agency contract. The court concluded that in the context of a civil suit, the word "employee" ought to be given a broader interpretation to achieve to public purpose underlying section 1090, the prevention of self-dealing. Having determined that a broader interpretation should be given, the court noted that a corporate consultant is as capable of influencing an official decision as an individual consultant, and as a consequence, corporate entities should be subject to the 1090 prohibition. The court then concluded that since Davis had alleged that HCC had served as a professional consultant to FUSD and had a hand in designing the plans and specifications of the school project, Davis had pled sufficient facts to establish a 1090 violation where HCC was awarded the project contracts.

[3] Davis pled sufficient facts to establish a common law conflict of interest

Having concluded that Davis had pled sufficient facts to establish a 1090 violation, the court found that Davis pled sufficient facts to establish a common law conflict of interest. The court

noted that Section 1090 codified a longstanding common law prohibition against self dealing in public contracts. The court explained that the statute's overlap of the common law is not complete, as the common law prohibits not only financial self interest, but also applies to nonfinancial interests that might cause a public official to have divided loyalties with respect to a particular governmental decision. The court concluded that since the complaint alleged sufficient facts to state a 1090 violation, it must state a common law conflict, since the purpose underlying 1090 is subsumed by the common law.