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**Office of
The City Attorney
City of San Diego**

**MEMORANDUM
MS 59**

(619) 533-5800

DATE: October 4, 2005

TO: Bob Kennedy, Project Manager
Redevelopment Agency

FROM: City Attorney

SUBJECT: Request for City Attorney's Opinion on Conflict of Interest issues

INTRODUCTION

This memorandum is in response to your request for an opinion regarding conflict of interest compliance issues relating to Project Area Committee (PAC) members. This memorandum responds to this request by generally outlining the conflict of interest analysis our office would perform when presented with facts related to a specific project. Obviously, whether a conflict of interest exists will greatly depend on the facts of each case.

The Political Reform Act of 1974 [Act], codified in California Government Code sections 81000-91015, is the main regulation governing conflict of interest analyses. It establishes a general rule that public officials are prohibited from making, participating in making or in any way attempting to use their official position to influence a governmental decision in which they know or have reason to know they have a financial interest. Cal. Gov't Code § 87100. A public official has a financial interest if the decision will have a reasonably foreseeable material financial effect on one or more of their economic interests, unless it is indistinguishable from the effect on the public generally. Cal. Gov't Code § 87103.

The Act identifies a specific list of high-ranking elected officials, who are subject to the most extensive disclosure requirements. These officials include the Mayor, City Attorney and city officials who manage public investments. Cal. Gov't. Code § 87200. When any of these high-ranking officials has a conflict of interest, the Act requires them to publicly announce the conflict, recuse himself or herself, and leave the room until after the discussion and voting on the

matter. Cal. Govt. Code § 87105. The Act does specifically allow for the public official to speak on the matter during the time the general public speaks on the issue. Cal. Govt. Code § 87105(a)(4).

PAC members are not covered by Cal. Gov't. Code section 87200. Instead, PAC members are created under section 87300, which requires the City to adopt conflict-of-interest codes for "positions which involve the making or participation in the making of decisions which may foreseeably have a material effect on any financial interest on the employee." Cal. Govt. Code § 87302(a). Because PAC members are not specifically identified in section 87200, the procedures mandated for officials so specified are not required by law for PAC members. However, the same principals behind those requirements seem applicable to PAC members. Therefore, using those procedures as guidelines for approaching PAC member conflict issues is appropriate.

Economic or financial interests include investments in business entities, interests in real property, positions in business entities, gifts received in the previous twelve months, and any sources of income. Investments, real property, gifts, and income must meet threshold dollar values set by the Act before they become potential sources of disqualification. Cal. Gov't Code § 87103.

An analysis under the Act must determine whether the economic interest is directly or indirectly involved in the governmental decision before the public official. Cal. Code Regs. tit. 2, § 18704. A person, including sources of income, business entities and sources of gifts, is directly involved in a governmental decision when that person, whether directly or by an agent: initiates the proceeding in which the decision will be made by filing an application, claim, appeal, or similar request; or is a named party in, or is the subject of, the proceeding before the official. Cal. Code Regs. tit. 2, § 18704.1. A person is the subject of a proceeding if a decision involves the issuance, renewal, approval, denial or revocation of any license, permit or other entitlement to the person. *Id.* Real property in which an official has an economic interest is directly involved in a governmental decision if it is within 500 feet of the boundaries of the property which is the subject of the decision. Cal. Code Regs. tit 2, § 18704.2.

An analysis must determine whether the effect on an official's economic interest is material. Generally, if the decision will have a significant effect on the official or a member of the official's immediate family, on the source of income or gifts to the official, or on the official's real property, the effect is material. Cal. Code Regs. tit. 2, § 18705. In addition, there are specific rules for each type of economic interest, depending on whether the economic interest is directly or indirectly involved in the governmental decision. For example, the regulations presume a material effect when the official's real property is directly involved in the decision. Cal. Code Regs. tit. 2, § 18705.2(a). This presumption may be rebutted by proof that it is not reasonably foreseeable the governmental decision will have any financial effect on the real property. *Id.* On the other hand, the regulations presume no material effect when the official's real property is indirectly involved in the decision. Cal. Code Regs. tit. 2, § 18705.2(b). Once again, this presumption may be rebutted with proof which makes it reasonably foreseeable that a material effect exists, such as evidence that the decision will affect the use of the real property in which the official has an economic interest. *Id.*

When a material financial effect on an economic interest exists, the analysis must also determine whether the effect is reasonably foreseeable. This is separate from the “reasonably foreseeable” analysis that occurs when determining whether a financial effect is material. The regulations consider a material effect reasonably foreseeable if it is substantially likely that the effect will occur. Cal. Code Regs. tit. 2, § 18706. While certainty is not required, if a material effect is a mere possibility, it is not reasonably foreseeable. *Downey Cares v. Downey Community Development Com.*, 196 Cal. App. 3d 983, 989-991 (1987). Relevant factors include the extent to which the official or the official’s source of income does business in the jurisdiction, and the scope of the governmental decision in question. Cal. Code Regs. tit. 2, § 18706.

Finally, even where a reasonably foreseeable material financial effect exists, a public official does not have a disqualifying conflict of interest in the governmental decision if it affects the public official's economic interests in a manner which is indistinguishable from the public generally. Cal. Code Regs. tit. 2, § 18707.

According to the Political Reform Act of 1974, an "interest in real property" includes any leasehold, beneficial or ownership interest or an option to acquire such an interest in real property located in the jurisdiction owned directly, indirectly or beneficially by the public official, or other filer, *or his or her immediate family* if the fair market value of the interest is two thousand dollars (\$2,000) or more. Interests in real property of an individual includes a pro rata share of interests in real property of any business entity or trust in which the individual or immediate family owns, directly, indirectly or beneficially, a 10-percent interest or greater.

Indirect investment or interest means any investment or interest owned by the spouse or dependent child of a public official, by an agent on behalf of a public official, or by a business entity or trust in which the official, the official's agents, spouse, and dependent children own directly, indirectly, or beneficially a 10-percent interest or greater. Cal.Gov.Code § 87103

In addition, the Ethics Commission Policy and San Diego City Council Policy state that an elected official or officer may not have financial or personal interest, either direct or indirect, that is incompatible with the proper discharge of his official duties.

QUESTIONS

Specific inquiries that you set forth are addressed as follows:

1. Definition of “immediate family.”

According to the California Government Code, “immediate family” means spouse and dependent children. (Gov. Code § 82029). The term “spouse” includes registered domestic partners recognized by state law according to California Code of Regulations § 18229.

Although the statutes are limited in their definition of immediate family, and that descriptive phrase is used in determining if a conflict of interest exists, it should be kept in mind that an

official's decisions that impact any family member's financial well-being may be closely scrutinized.

2. Definition of "ownership."

A conflict of interest arises when a public official has an "economic interest" in real property, the subject of a governmental decision. Such an interest exists if the official has any interest in such property. A public official does not have an economic interest if he or she has only a "remote interest" in the property. A person may be considered to have only a remote interest, even if he has a financial interest in a contract, if he does not participate in the formulation of a contract.

The interest proscribed by Cal.Gov. Code, § 1090 (public officers or employees shall not be financially interested in any contract made by them in their official capacity), is an interest in the contract. The purpose of the prohibition is to prevent a situation where a public official would stand to gain or lose something with respect to the making of a contract over which in his or her official capacity he or she could exercise some influence.

a. Case law

Case law has taken a very expansive view of when there is a conflict of interest:

"However devious and winding the trail may be which connects the officer with the forbidden contract, if it can be followed and the connection made, a conflict of interest is established." [quoting *People v. Watson*, 15 Cal. App. 3d at p. 37, in *People v. Honig* 48 Cal. App. 4th 289, 315 (1996).]

Conflict-of-interest statutes are concerned with any interest, other than perhaps remote or minimal interest, that would prevent officials involved from exercising absolute loyalty and undivided allegiance to best interests of the state; the fact that an officer's interest might be small or indirect is immaterial so long as it is such as deprives state of his overriding fidelity to it and places him in compromising situation where, in exercise of his official judgment or discretion, he may be influenced by personal considerations rather than public good. Cal.Gov.Code §§ 1090, 1097; *People v. Honig* 48 Cal. App. 4th 289 (Cal. App. 3 Dist.,1996)

"The term 'financially interested' in Gov. Code section 1090 cannot be interpreted in a restricted and technical manner. The law does not require that a public officer acquire a transferable interest in the forbidden contract before he may be amenable to the inhibition of the statute, nor does it require that the officer share directly in the profits to be realized from a contract in order to have a prohibited interest in it." [Quoting *People v. Vallerger*, 67 Cal. App. 3d at p. 865 in *People v. Honig* 48 Cal. App. 4th 289, 315 (1996).]

As illustrated by the above examples, the fact that an officer's interest might be small or indirect is immaterial so long as it is such as deprives the state of the officer's overriding fidelity to it and places the officer in the compromising situation where, in the exercise of his or her official judgment or discretion, the officer may be influenced by personal considerations rather than the

public good. Moreover, prohibited financial interests are not limited to express agreements for benefit and need not be proven by direct evidence. Rather, forbidden interests extend to expectations of benefit by express or implied agreement and may be inferred from the circumstances. *People v. Gnass*, 101 Cal. App. 4th 1271 (5th Dist. 2002).

A creditor-debtor relationship constitutes a prohibited financial interest under Gov C § 1090. *People v. Watson* (1971) 15 Cal. App.3d 28. Where a city council overturned the planning commission's approval of a building project on the ground that the proposed building was excessive in size, despite the fact that the proposal conformed to municipal code height restrictions, the property owners were denied a fair hearing. Among other reasons, one council member, who lived near the property owners and had complained when the commission approved the project, had a conflict of interest in voting on the project. It was irrelevant that the council member rented the residence in which the member resided; an interest in preserving the council member's ocean view was of such importance to the member that it could have influenced the member's judgment. Moreover, the council member harbored personal animosity toward the owners. *Clark v. City of Hermosa Beach* (1996) 48 Cal. App. 4th 1152, 56 Cal.Rptr.2d 223.

b. Remote Interest

Government Code §1091.5(a) provides:

“An officer or employee shall not be deemed to be interested in a contract if his or her interest is any of the following:

- (1) The ownership of less than 3 percent of the shares of a corporation for profit, provided that the total annual income to him or her from dividends, including the value of stock dividends, from the corporation does not exceed 5 percent of his or her total annual income, and any other payments made to him or her by the corporation do not exceed 5 percent of his or her total annual income.
- (2) That of an officer in being reimbursed for his or her actual and necessary expenses incurred in the performance of official duty.”

"Remote interest" is defined to include, among other interests,

- (1) that of an officer or employee of a nonprofit corporation, generally;
- (2) that of an employee or agent of a contracting party having at least 10 other employees, where the officer was thus employed for at least three years before taking public office and where the officer owns less than 3 percent of shares of stock of the contracting party; and the employee or agent is not an officer or agent of the contracting party and did not directly participate in formulating the bid of the contracting party;
- (3) that of an employee or agent of a contracting party, where certain other conditions are met;
- (4) that of a parent in the earnings of his or her minor child for personal services;
- (5) that of a landlord or tenant of a contracting party;

(6) that of an attorney of the contracting party, or that of an owner, officer, employee, or agent of a firm that renders, or has rendered, service to the contracting party in the capacity of stockbroker, insurance agent or broker, or real estate agent or broker, if these individuals have not received and will not receive remuneration, consideration, or a commission as a result of the contract, and have an ownership interest of at least a certain percent in the law practice or firm, stock brokerage firm, insurance firm, or real estate firm;

(7) that of a member of a nonprofit corporation formed for the sole purpose of merchandising agricultural products or the supplying of water;

(8) that of a supplier of goods or services when those goods or services had been supplied to the contracting party by the officer for at least a specified number of years prior to his or her election or appointment to office;

(9) that of a director of, or a person having an ownership interest of a specified percent or more in, a bank, bank holding company, or savings and loan association with which a party to the contract has a relationship of borrower or depositor, debtor or creditor;

(10) that of an engineer, geologist, or architect employed by a consulting engineering or architectural firm who does not serve in a primary management capacity;

(11) that of an elected official, otherwise subject to the prohibition against holding a financial interest in a contract made in an official capacity, in any housing assistance payment contract, provided that contract was in existence before the statutory prohibition became applicable to the officer and will be renewed or extended only as to the existing tenant, or, in a jurisdiction in which the vacancy rate is less than 5 percent, as to new tenants in a unit previously under a Section 8 housing contract; and

(12) that of a person receiving salary, per diem, or reimbursement for expenses from a government entity.

c. Interests in Trusts

An official has an economic interest in the pro rata share of the interests in real property, sources of income, and investments of a trust in which the official has a direct, indirect, or beneficial interest of 10 percent or greater.

The interests of the official include those of the official, spouse, and dependent children regarding interests in real property and investments and those of the official and spouse regarding sources of income.

For purposes of determining whether an official has an economic interest in interests in real property, sources of income, and investments of a trust, the official *has a direct, indirect, or beneficial interest* in a trust if the official is:

(1) A trustor and:

(A) Can revoke or terminate the trust;

(B) Has retained or reserved any rights to the income or principal of the trust, or

retained any reversionary or remainder interest; or

(C) Has retained or reserved any power of appointment, including but not limited to the power to change the trustee, or the power to amend, alter or designate, either alone or in conjunction with anyone else, the person or persons who shall possess or enjoy the trust property or income.

(2) A beneficiary and:

(A) Presently receives income; or

(B) Has an irrevocable future right to receive income or principal. For purposes of this subsection, an individual has an irrevocable future right to receive income or principal if the trust is irrevocable, unless one of the following applies:

(i) Powers exist to consume, invade, or appoint the principal for the benefit of beneficiaries other than the official and such powers are not limited by an ascertainable standard relating to the health, education, support, or maintenance of the beneficiaries; or

(ii) Under the terms of the trust, someone other than the official can designate the persons who shall possess or enjoy the trust property or income.

An official does not have a direct, indirect, or beneficial interest in a trust solely because the official is a trustee or co-trustee. 2 CA ADC § 18234

An official must (1) disclose the pro rata share of a trust's interests in real property or investments, or income deriving from any such interests or investments, if the interests or investments were originally transferred into the trust, and (2) disqualify himself or herself from participating in decisions which may have a foreseeable and material effect on financial interests of the trust.

In instances of a blind trust, to qualify as a remote interest, the following conditions must apply:

(1) the trustee must be a disinterested party other than the official's spouse, child, parent, grandparent, grandchild, brother, sister, parent-in-law, brother-in-law, sister-in-law, aunt, uncle, or first cousin or the spouse of any such person;

(2) the trustee must be given complete discretion to manage the trust including, but not limited to, the power to dispose of and acquire trust assets without consulting or notifying the official;

(3) the trustee must be required to notify the official of the date of disposition and value at disposition of any original investments or interests in real property so that information can be reported on the official's next Statement of Economic Interests;

(4) the trustee must be prohibited from disclosing to the official any information concerning the replacement assets except for information required under this subsection or the minimum tax information which lists only the totals of taxable items from the trust and does not describe the source of any individual item of income; and

(5) if the trust is revoked while the official is a public official, or if the official learns of any replacement assets of the trust, the official must file an amendment to the most recent Statement of Economic Interests disclosing the date of revocation and the previously unreported pro rata share of the trust's interests in real property or investments or income deriving from any such interests in real property or investments and disqualify himself or herself, as necessary.

d. Banks

A bank may act as a depository, paying agent, trustee, or fiscal agent for the holding or handling of public funds or securities notwithstanding the fact that a member of the legislative body or an officer or employee of the depositor is an officer, employee, or stockholder of such bank, or of a holding company that owns any of the stock of such bank. Such member of a legislative body, or such officer or employee thereof, shall not be deemed "interested in any contract" as that phrase is used in Section 1090 of the Government Code, if his sole interest is the fact that he is an officer, employee, or stockholder of the bank selected to act as such depository, paying agent or fiscal agent.

e. Nonprofit Corporation

An officer or employee *shall not be deemed interested* in any contract if his interest is that of (1) a bona fide nonprofit, tax-exempt corporation having among its primary purposes the conservation, preservation, or restoration of park and natural lands or historical resources for public benefit, which enters into an agreement with a public agency to provide services related to park and natural lands or historical resources and which services are found by the public agency, prior to entering into the agreement or as part of the agreement, to be necessary to the public interest, and (2) an officer, director, or employee acting pursuant to the agreement on behalf of the nonprofit corporation. Govt. Code § 1091.5(a)(12)

f. Summary

The interest contemplated by the rule generally includes, but is not confined to, any actual or direct financial gain on the city officer's or employee's part. It may be any interest, other than perhaps a remote or minimal interest, that would *prevent* the municipal officer or employee involved *from exercising absolute loyalty and undivided allegiance* to the best interests of the city.

The rule prohibiting city officers' financial interest in any contract made in their official capacity, does not apply where the officer's interest is not one existing at the time of the award of the

contract, but is acquired afterward. An interest that is common to all persons similarly situated does not constitute a prohibited interest.

3. When must a PAC member resign or withdraw from participation on a matter?

An interested public official should not take part in any action on the matter in which he has a conflict of interest. Therefore, he should abstain from all discussions and decisions relating to the contract, from inception to formal agreement. The purpose of the restrictions is to avoid the opportunity of introducing any input or undue influence regarding a matter that may be biased. A person is disqualified to discharge the services of a position in a municipal government when he has a personal interest which might interfere with the unbiased discharge of his duty to the public or prevent his exercise of absolute loyalty to best interests of city. *Raymond v. Bartlett* (1947) 175 P.2d 288, 77 Cal. App.2d 283.

For the purpose of construing the statute prohibiting city officers' financial interest in any contract made in their official capacity, a contract "made" in an official capacity includes preliminary discussions, negotiations, compromises, and reasoning. *Campagna v. City of Sanger* (App. 5 Dist. 1996) 49 Cal. Rptr.2d 676; Cal.Gov.Code § 1090.

To warrant conviction for violation of conflict-of-interest statutes prohibiting public employees from being financially interested in any contract made by them in their official capacity, it is not necessary that official's financial interest be "material," or that it be "direct," as opposed to indirect. *People v. Honig* (App. 3 Dist. 1996) 48 Cal. App. 4th 289; Gov.Code § 1090.

4. What happens when a PAC member refuses to abstain?

Government Code Section 18700 states that "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."

Members of the Legislature, state, county, district, judicial district, and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members. Gov.Code § 1090

In addition, San Diego City Council policy 000-4 requires that no elected official, officer, appointee or employee of the City of San Diego engages in any business or transaction that is incompatible with the proper discharge of his duties or would tend to impair his independence or judgment in performing such duties. A PAC member is charged with the responsibility not only to refrain from acting in a manner that might be a conflict of interest, but to act appropriately in such instances.

Therefore, a member's refusal to comply with recusing himself from a matter where there is a conflict is a violation of an official's duty under both statute and policy. We believe that educating members about their duties in accordance with statutory law and policy will be sufficient encouragement that they comply.

Members' conflicts of interests may be announced openly by the Chairperson. Gov. Code § 87105 (a)(1). Though the statutes do not require a PAC member to recuse themselves from a meeting in the case of a conflict, since they are not included in the list of officials for whom such requirements apply, it would be appropriate for them to do so. The meeting should not be canceled or continued if at all possible, because as you have pointed out, such a tactic could be used to delay a contentious matter.

5. Recusal.

The individual with a conflict of interest should recuse himself from discussing and voting on the issue. To avoid the appearance of impropriety, it would be appropriate for the individual to leave the room after public identification is made of the type of economic interest held by the official that gives rise to the conflict. Only sufficient detail to allow the nature of the conflict to be understood by the public is required – disclosure of the exact street address of a residence, for example, is not required. Gov. Code 87105(a)(1).

As indicated earlier in this memorandum, there is no specified disqualification procedure for persons falling in this category of "public official." Neither the Act nor implementing regulation requires this type of official to leave the room. Cal. Code Regs., tit.2 § 18702.1(a)(b), (b) and (c). Nothing in these regulations either authorizes or prohibits an agency by local rule or custom from requiring a disqualified member to step down from the committee and/or leave the meeting room. The City of San Diego does not have an official policy on this specific question. However, in order to prevent the appearance of impropriety, the PAC member may elect to and probably should leave the room.

The purpose of removal of oneself from the meeting room is to avoid undue influence on the other members who might be aware of the recused member's interests and desires relating to the property or transaction. In an effort to allow those remaining members the ability to freely express their opinions and concerns, it is advisable for the interested member to be outside the meeting room.

Notwithstanding the above, such a public official may speak on the matter during the time that the general public speaks on the issue. Gov. Code § 87105 (a)(4).

In no instance may such a person vote on the matter.

Redevelopment Project Manager

October 4, 2005

Page 11

An official or a public employee may be convicted of a violation Gov. Code, §§ 1090 and 1097, no matter whether he or she actually participated personally in the execution of the questioned contract, if it is established that the official had the opportunity to, and did, influence execution directly or indirectly to promote his or her personal interests. *People v. Gnass*, 101 Cal. App. 4th 1271 (5th Dist. 2002).

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