

CHAPTER 2:

Personal Financial Gain Laws



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Receiving Special Favors or Money for Official Actions

BASIC RULES

Perhaps the most blatant and extreme form of using one's public position for financial gain is graft. Graft involves using one's public position to get money or anything else of value. Examples of graft include bribery and extortion.

A bribe involves conferring a benefit on a public official to influence a person's vote, opinion, action or in-action.¹ Asking for that bribe is illegal, of course, but so is receiving one or agreeing to receive one.² Under California's criminal laws, a "bribe" includes anything of value; it also includes receiving "advantages." The advantage can be a future one and need not involve the payment of money.³ The federal law definition of bribery is even broader.⁴

Extortion involves, among other things, getting something from someone by wrongfully using one's public position.⁵ For example, a public official may not demand money in return for the performance of his or her official duties.⁶ This includes demanding campaign contributions in return for action in one's official capacity.

Public officials are also forbidden from receiving a reward for appointing someone to public office or permitting someone to perform the duties of their offices.⁷

PENALTIES

California Law Penalties

Bribery

Receiving or agreeing to receive a bribe is a crime, punishable by a combination of prison time, fines and forfeiting and being forever disqualified from holding public office.⁸

Fines vary according to whether the bribe was actually received. If it was, the fine is a minimum of \$2,000 up to either \$10,000 or double the amount of the bribe, whichever is greater. If a bribe was not actually received, there still is a fine between \$2,000 and \$10,000. The specified prison sentence is two to four years in state prison.

Those who offer bribes also face penalties. Those who bribe a member of a legislative body of a city, county, school district or other special district face two to four years in state prison.⁹

Extortion

Extortion by public officials is a misdemeanor.¹⁰ Misdemeanors are punishable by up to six months in county jail, a fine of up to \$1,000 or both.¹¹ Extortion can also be the basis for a grand jury to initiate removal-from-office proceedings (also known as "quo warranto") for official misconduct.¹²

Appointing Someone to Office

An official who receives payment or favors for making an appointment faces the following punishments: forfeiture of office, disqualification from ever holding public office again and a fine of up to \$10,000.¹³

DON'T COUNT ON A CODE OF SILENCE

Faced with the temptation of receiving a bribe, it can be easy to underestimate the chances of being caught, let alone successfully prosecuted. Fortunately, bribery is fairly rare, which may lead one to mistakenly assume prosecutors never find out about bribery.

In some instances, prosecutors learn about illicit activities from informants from within an agency. In other instances, those who believe they have been asked for a bribe will turn the asking officials in. Sometimes, observers will notice that a public official seems to have more resources than before and start asking questions.

The media views itself as a key watchdog on such issues, of course. Unfortunately, some officials discount the likelihood of getting caught and prosecuted. They figure that everyone involved in illicit activities will have a strong incentive to keep quiet. What they don't realize is that prosecutors can offer powerful incentives to those involved to testify against others in exchange for reduced penalties, and that the prospect of successfully prosecuting an elected official provides prosecutors a high-visibility opportunity to make an example of an offender, perhaps reasoning that such an example will serve as a deterrent to others.

IF I GET INTO TROUBLE, CAN THE AGENCY PAY MY DEFENSE?

Don't count on it. To provide a defense in a criminal action, for example, the agency must find that:

1. The criminal action or proceeding is brought on account of an act or omission in the official's service to the public entity;
2. Such defense would be in the best interests of the public entity; and
3. The individual's actions were in good faith, without actual malice and in the apparent interests of the public entity.¹⁴

If the issue is whether a public official misused his or her office for personal gain, it may be particularly difficult for the agency to make the third finding, which is that the actions were in the apparent interests of the public entity. Moreover, even if the agency could make these findings, it is not required to. Indeed, there may be strong political pressures not to.

Similarly, an agency may refuse to provide a defense in a civil action if it finds the actions in question related to corruption or fraud.¹⁵ Also, public agencies are not responsible for damage awards designed to punish or make an example of someone (known as "punitive" or "exemplary" damages).¹⁶

Note that, in these situations, the agency's attorney is not the public official's personal attorney, with attendant protections for attorney-client confidences. The agency attorney's legal and ethical obligations are to the agency itself- not to any one official in that agency.¹⁷

FEDERAL PENALTIES

If an agency receives more than \$10,000 in federal funding, an official of that agency could find him or herself subject to federal prosecution if the amount involved in an ethical violation (for example, a bribe) exceeds \$5,000.¹⁸ The penalty for bribery under federal law is a fine of up to twice the amount of the bribe or \$250,000 (whichever is greater), up to 10 years imprisonment, or both.¹⁹

Bribery, extortion, or embezzlement can also be basis of a federal income tax evasion charge. Federal prosecutors may treat money that an official receives through illicit means as income to the official. If the official fails to report this income at tax time (which of course, most don't), the official becomes subject to an action for income tax evasion.

Income tax evasion carries with it a possible five-year prison term and a fine of up to \$100,000.²⁰ In addition, prosecutors can require the defendant to pay for the costs of prosecution (in addition to one's own defense costs).²¹

The sometimes-related crime of filing a false tax return is punishable by a maximum three-year prison term and a fine of up to \$100,000 (along with the costs of prosecution).²²

A court can also order a convicted official to pay restitution to the agency in the amount of the money or advantage received (or lost to the agency) as the result of criminal misuse of the official's position.²³

FOR MORE INFORMATION

On penalties for ethics law violations, see www.ca-ilg.org/consequences.

MAKING A FEDERAL CASE OUT OF CORRUPTION

Honest Services Fraud

Under federal wire and mail fraud laws, the public has the right to the “honest services” of public officials.²⁴

The basic concept is that a public official owes a duty of loyalty and honesty to the public—similar to a trustee or fiduciary.²⁵ That duty is violated when a public official makes a decision that is not motivated by the public’s interests but instead by his or her personal interests.²⁶

A clear example is when an official receives a personal financial gain as the result of his or her public service. Examples include bribes and kickbacks (for example, receiving money back from proceeds paid to a company that does business with a public entity).²⁷

Sometimes violation of a state law is the basis of an “honest services” fraud claim (in addition to other charges, like income tax evasion). However, the courts have also held that such claims can also be based on common or judge-made law concepts relating to a public official’s fiduciary duties to his or her constituents.

The potential penalties for federal fraud are steep. The maximum penalty for being guilty of wire and/or mail fraud includes a jail term of up to 20 years and a \$250,000 fine.²⁸

For more information, see “Making a Federal Case Out of Corruption,” available at www.ca-ilg.org/fedcase.

Disqualification Based on Financial Interests Under the Political Reform Act

BASIC RULES

In the statewide general election of 1974, voters passed the Political Reform Act, creating an independent authority, the Fair Political Practices Commission (FPPC), to, among other things, administer and enforce an across-the-board, bright line rule: public officials may not participate in governmental decisions affecting their financial interests.

The rule is designed to have public officials avoid putting themselves in the position of choosing between advancing the public's interest or their own financial interests. That would be a potential conflict of interest.

This does not mean there is anything corrupt or dishonest about having a disqualifying conflict of interest; nor is it against the law to have a disqualifying conflict of interest. It typically means that a public official has a personal life, with all the financial realities that life can involve. The key is to be aware when one's economic interests are implicated by a public agency decision, so one can stay clear of and avoid the decision-making process. This way, there is no question about whether one's personal interests affected the decision-making process in any way.

The rule is that a public official may not make, participate in, or influence a governmental decision that will have a reasonably foreseeable and material financial effect on the official, the official's immediate family, or any of the official's economic interests.²⁹

Economic interests include real property, sources of income, business entities in which a public official has an investment or holds a management position, and donors of gifts.



Note the breadth of the disqualification requirement: one must not only step aside from voting, but the entire process leading up to a governmental decision....

Note the breadth of the disqualification requirement: one must not only step aside from voting, but the entire process leading up to a governmental decision, whether a vote of a legislative body or an action or decision by an employee vested with the authority to act on behalf of the agency. This means conversations with fellow officials and staff are also against the law if one has a conflict of interest. Also, there may be even more restrictive local requirements.

Note that disqualified officials do not count toward the establishment of a quorum.³⁰

Updates to the Political Reform Act Conflict of Interest Regulations

The FPPC has updated conflict of interest regulations under the Political Reform Act. These changes are significant and have changed several key parts of the conflict of interest analysis, including: material business interests, what is "reasonably foreseeable," the 500 foot real property rule, the public generally exception and overall streamlining of the 8-step conflict of interest analysis.

For more information on these updates to the conflict of interest regulations, see the FPPC webpage for newly adopted, amended or repealed regulations at: www.fppc.ca.gov/the-law/fppc-regulations/newly-adopted-amended-or-repealed-regulations.html. Also seek professional guidance when facing a potential conflict of interest issue as the rules and regulations can be complicated.

Imprecise Terminology: Abstentions, and Disqualifications

The terms “abstention,” and “disqualification” are sometimes used interchangeably when describing an official's decision to step aside from the decision-making process, and the applicable laws do not necessarily mandate the use of any particular term. The important thing is to be clear on *why* a decision-maker is stepping aside.

Voluntary Abstention

There are instances in which a public official voluntarily chooses not to participate in a decision by “abstaining” from the vote. The official may know it will be difficult to put personal interests aside and make a decision based solely on the public's interest. Or, the official may worry the public will perceive the official cannot put personal interests aside even if the official knows the he or she can.

The decision to voluntarily refrain from participating in the decision-making process can involve two conflicting values:

1. One's responsibility to perform the duties of his or her office; and
2. One's responsibility to honor one's own ethical standards or the public's trust in the decision-making process.

Both responsibilities are important, of course. Because of this, deciding not to participate should not be viewed as a way of avoiding difficult decisions.

Mandatory Disqualification

By contrast, when someone has a disqualifying conflict of interest, there is no choice. The law prohibits that individual from participating in or seeking to influence a decision—even if the official believes he or she can be fair. The law presumes the public will doubt a person's ability to be fair. This is an example of avoiding the appearance of impropriety as well as the potential for actual impropriety.

Political Reform Act – The Four Step Conflict of Interest Test

The process of determining when an official is disqualified from participating in a decision can be a very complex one, depending on the interests involved and the governmental decision contemplated. There are statutes, regulations, and interpretive opinions that flesh out each aspect of the basic prohibition.

To organize the analysis, the FPPC has adopted a new four-step procedure (trimmed down from an eight-step analysis that had been used for many years) for identifying when one must disqualify oneself from participating in a matter. Although it is useful to be aware of the general outlines of the process, the analysis is probably best undertaken with the assistance of agency attorneys and/or the FPPC staff—particularly since the rules are not necessarily logical or intuitive.

1. Is it reasonably foreseeable that a governmental decision will have a financial effect on any of the public official's financial interests?
2. Will the reasonably foreseeable financial effect be material?
3. Can the public official demonstrate that the material financial effect on the public official's financial interest is indistinguishable from its effect on the public generally?
4. If, after applying the three steps above the public official determines they have a conflict of interest, he or she may not make, participate in making, or in any way attempt to use his or her official position to influence the governmental decision, unless some exception applies.

Evaluating each of these four steps involves fact-specific inquiries that must be guided by the standards and definitions laid out in the regulations.³¹

ETHICS CODE VERSUS LOCAL CONFLICT OF INTEREST CODES

California's Political Reform Act requires local agencies to adopt local conflict of interest codes.³² These codes supplement state law, by specifying which positions in the agency are subject to disclosure under the Act.

For more information, see "About Local Conflict of Interest Codes" (available at www.ca-ilg.org/local-conflict-of-interest-codes) and the FPPC's materials on adopting local conflict of interest codes (see <http://www.fppc.ca.gov/learn/rules-on-conflict-of-interest-codes/local-government-agencies-adopting-amending-coi.html>).

FOR MORE INFORMATION

See the following resources:

- » "Deciding When Not to Participate in an Agency Decision: Abstentions and Disqualifications," available at www.ca-ilg.org/abstentions.
- » "Property Ownership in Your Jurisdiction," available at www.ca-ilg.org/owningproperty.

For specific questions, please contact agency counsel or the FPPC at 1-866-ASK-FPPC (866-275-3772 *2) or Advice@fppc.ca.gov.

GETTING ADVICE AND STAYING OUT OF TROUBLE ON POLITICAL REFORM ACT ISSUES

Public officials should seek advice on how these laws apply as early in the process as possible — as soon as a disqualifying conflict of interest is even a possibility. This means taking an active and attentive role by asking questions when items are placed on an agency agenda or mentioned or discussed as part of an agency's business. For example, when a city manager or other executive previews items or programs during a report, or when staff responds to a question from a constituent, if it becomes evident that a governmental decision within the meaning of the law is contemplated, the public official should immediately ask themselves whether any of their financial interests might be affected, and, if so, seek advice about whether they have an actual conflict.

Early consultation allows an attorney to analyze all of the facts involved and the relevant law. Even though the analysis is laid out in four specific steps, each step has various rules and FPPC regulations associated with it, which can be complex. As one seasoned local agency attorney has observed, the later in the process the consultation occurs, the more likely the advice will be that disqualification must occur to make sure the official stays out of trouble.

Does advice from agency counsel protect an official against a FPPC enforcement action? No. Only a formal opinion or formal advice letter from the FPPC will protect a public official if someone argues that a violation of the Political Reform Act has occurred. Receiving such advice from the Commission takes time — another good reason to raise the conflict issue as early as possible.

Identifying Economic Issues

WHAT KINDS OF ECONOMIC INTERESTS ARE A CONCERN?

There are a number of ways to have a financial interest in a decision:

- » **Sources of Income.** Receiving \$500 or more in income from one source (including any income received from a business, nonprofit organization, government agency, or individual) within twelve months prior to the decision creates an economic interest. “Sources of income” includes a community property interest in a spouse or domestic partner’s³³ income, but not separate property income.³⁴ Additionally, if someone promises an official \$500 or more twelve months prior to the decision, the person or entity promising the money is a source of income, even if the income has yet to be received by the official, as long as the official has a legally-enforceable right to the promised income.³⁵
- » **Investments.** An economic interest is created if the official, the official’s spouse or domestic partner⁴¹ (even as separate property), or dependent children (or anyone acting on their behalf) has an investment worth \$2,000 or more in a business entity (even if the official does not receive income from the business).⁴² Investments include stocks and corporate (though not government) bonds.
- » **Business Employment or Management.** If the official serves as a director, officer, partner, trustee, employee or otherwise serves in a management position in a company, an economic interest is created.⁴³ Note this does not apply to a member of the board of a nonprofit entity.
- » **Related Businesses.** The official has an economic interest in a business that is the parent, subsidiary or is otherwise related to a business where the official:
 - Has a direct or indirect investment worth \$2000 or more; or
 - Is a director, officer, partner, trustee, employee, or manager.⁴⁴
- » **Personal Finances.** An official has an economic interest in their own expenses, income, assets, or liabilities and those of the official’s immediate family (spouse or domestic partner³⁶ and dependent children).³⁷
- » **Real Property.** An interest in real property worth \$2,000 or more creates an economic interest.³⁸ The interest may be held by the official, the official’s spouse or domestic partner³⁹ (even as separate property) and children (or anyone acting on their behalf). Real property interests can also be created through leases, loans, mortgage, or security interests in property.⁴⁰
- » **Business-Owned Property.** A direct or indirect ownership interest in a business entity or trust that owns real property is another form of economic interest.⁴⁵
- » **Loans.** A loan from someone (or guarantee on a loan) can create an economic interest unless the loan is from a commercial institution, made in the regular course of business and is on the same terms as are available to members of the public.⁴⁶
- » **Gifts.** Receiving gifts totaling \$460 (2015-16) or more in a twelve-month period prior to the decision from any one person or organization may create an economic interest depending on the type of public official involved and whether the gift-giver is in the agency’s jurisdiction.⁴⁷ Being promised a gift of \$460 (2015-16) or more within a twelve-month period prior to the decision can also create a disqualifying financial interest.⁴⁸ The limit is adjusted every two years to reflect changes in the cost of living.⁴⁹ For more discussion of the gift issue, please see Chapter 3, and [www.ca-ilg.org/ GiftCenter](http://www.ca-ilg.org/GiftCenter).

The timeline for determining whether an official has a potentially disqualifying economic interest is **twelve months before the decision** in question—not the calendar year.⁵⁰

If a public official thinks he or she has one of the economic interests described above, the next step is to consult with the agency attorney about the situation and how the FPPC’s four-step conflict of interest analysis applies. One of the key purposes of the disclosure requirements is to enable the public to assess whether an official’s financial interests may affect his or her decision-making. The disclosure requirements are discussed in further detail in Chapter 4.

DISCLOSURE OF CONFIDENTIAL INFORMATION

California law also makes disclosure of certain kinds of confidential information for personal financial gain (as defined) a misdemeanor.⁵¹ This restriction applies to public officers and employees.⁵² Confidential information means information not subject to disclosure under the Public Records Act and information that may not be disclosed by statute, regulation, or rule.⁵³

REAL PROPERTY INTERESTS

The previous FPPC regulations analyzed real property conflicts in a two-step process. The first step was to determine if the official's property was "directly" or "indirectly" involved in the decision and then to determine if the decision would have a "material" effect on the official's property. The old regulations described a number of different types of decisions, and provided that if the official's property was the subject of one of those types of decisions, the property was deemed to be "directly" involved in the decision. In addition, there was a rule based upon the proximity of the official's property in relation to other property that was the subject of the decision. If the official's property was within 500 feet of the subject property, the official's property was deemed to be "directly" involved in the decision. If the official's property did not fall within any of the circumstances described in the old rule, the official's property was considered to be "indirectly" involved in the decision.

In 2014, the FPPC amended its regulations to simplify the property interests analysis by dispensing with the "directly" versus "indirectly involved" dichotomy. Now, a real property interest is examined in light of its "materiality" only.⁵⁴

Before the change, if the official's property was located within 500 feet of property that was the subject of a governmental decision, the financial impacts of the decision on the official's property were **presumed** to be material. The presumption could be rebutted, however, by showing that the decision would not have **any** impact on the value of the official's property.

Now, the 500 foot rule is still a part of the new regulation but the presumption of materiality can only be rebutted by written advice from the FPPC finding that the decision will have no measureable impact on the value of the official's property.

THE “PUBLIC GENERALLY” ANALYSIS

Additionally, the recent changes to the regulation ushered in a new “**Reasonably Prudent Person**” standard, which serves as a sort of “catch-all” exemption. Specifically, even if an official’s property is not the subject of the decision, or is located well beyond 500 feet from the subject property, the official must consider whether “...a reasonably prudent person, using due care and consideration under the circumstances, [would] believe that the governmental decision was of such a nature that its reasonably foreseeable effect would influence the market value of the official’s property.”

For interests in common areas, such as in a residential condominium complex or an industrial lease that includes areas in common with other tenants, the new regulations redefine “real property in which an official has an interest” to exclude an official’s undivided interest in common area, thus offering another simplification of the real property interest analysis.

For interests in business properties, under the updated regulations, the effects of the decision on the official’s real property interest do not have to be considered when the decision involves the issuance of a permit or entitlement, or when one is considering the impact of the decision on the income producing potential of the property. When applying those factors, only the impacts on the official’s business entity interest are to be considered.⁵⁵

Under the FPPC’s Four-Step Test, if the effect of a decision on the public official’s interests is indistinguishable from the effect on the public generally, the public official may participate in the decision even if the decision would otherwise materially affect the official’s economic interests.

In 2015, the FPPC revised the analysis to simplify the previous general rule and various exceptions; the former nine separate regulations were consolidated into a single regulation,⁵⁶ which now provides that an official may participate in a decision “if the official establishes that a significant segment of the public is affected and the effect on his or her financial interest is not unique compared to the effect on the significant segment.” A “significant segment is defined as at least 25% of:

- » All businesses or nonprofit entities in the jurisdiction;
- » All real property (commercial or residential) in the jurisdiction; or
- » All individuals in the jurisdiction.

The effect of a decision on an official’s interest is considered unique if it results in a **disproportionate effect** on:

- » The development potential, use, or income-producing potential of real property or a business entity in which the public official has an interest;
- » The official’s business entity or real property because of how close business or the property is to the project that is the subject of the decision;
- » The official’s business entity or real property interests as a result of the cumulative effect of the official’s multiple interests in similar entities or properties that is substantially greater than the effect on a single interest;
- » The official’s business entity or real property interests as a result of the public official’s substantially greater business volume or larger real property the size when the decision will affect all interests by the same or similar rate or percentage;
- » A person’s income, investments, assets or liabilities, or real property if the person is a source of income or gifts to the official; or
- » The official’s personal finances or those of his or her immediate family.⁵⁷

WHAT HAPPENS IF AN OFFICIAL IS DISQUALIFIED?

General Rule

If an official is disqualified from participating on a specific agenda item under the conflict of interest rules established by the Political Reform Act, the official must:

- » If the decision is being voted on at a public meeting, verbally identify the financial interest or potential conflict of interest in sufficient detail to be understood by the public; and
- » Not attempt to influence the decision in any way, which includes talking with colleagues or staff about the matter at any time, including before, during, or after any meeting at which the item may be taken up.

At the meeting, elected and appointed officials, and top staff members who have conflicts of interest must leave the room when that matter is up for decision (unless the matter is on consent, in which case the official must declare the conflict and have the clerk record an abstention on that particular item).⁵⁸ This may be a good practice for comparable officials at other local agencies as well.

Officials subject to the leave-the-room requirement will also need to explain why they are disqualified from participating, based on the nature of the financial interest.⁵⁹ For example:

- » **Investment.** If the interest relates to an investment, provide the name of the business in which the investment is held.
- » **Business Position.** If the interest relates to a business position, give a general description of the activity in which the business is engaged as well as the name of the business.
- » **Real Property.** If the interest relates to real property, supply the address or another indication of the location of the property (unless the property is the public official's principal or personal residence, in which case explain the property is a residence and do not give the address or location).
- » **Income or Gifts.** If the interest relates to the receipt of income or gifts, then describe the source.
- » **Personal Finances.** If the interest relates to a personal financial interest in the decision, then describe the expense, liability, asset or income affected.

Exceptions to the Leave-the-Room Requirement

There are limited exceptions that allow a disqualified official to remain in the room and provide input as a member of the public to represent himself or herself on matters related solely to the official's "personal interests."⁶⁰

These include when the subject of the discussion is:

- » Interests in real property wholly owned by the official or his or her immediate family;⁶¹
- » Interests in a business entity wholly owned by the official or his or her immediate family;⁶² and
- » Interests in a business entity over which the official (or the official and his or her spouse or domestic partner⁶³) exercises sole direction and control.⁶⁴

Even though the law allows the public official to remain in the room when these interests are at stake, the public official may still wish to balance that option with the potential that the public may nonetheless perceive the official is improperly trying to influence his or her colleagues. Many officials balance their rights as individuals with their responsibility to maintain the public's trust in both their leadership and the agency that they serve by leaving the room after having provided their input related to their personal interest.

Note on Closed Sessions

If a decision will be made or discussed in a closed session, an official with a conflict may not be present. Nor may the official obtain non-public information about the closed session.⁶⁵

Effect of Disqualification

The general rule is a majority of the membership of a body must be present in order for the decision-making body to conduct business—a concept known as a quorum.⁶⁶

For some kinds of agencies, a majority of the quorum is necessary for an item to pass, although there are special rules that apply to certain kinds of actions. Note, however, the rule is different for county boards of supervisors, community college boards and school boards, which generally require a majority vote of the entire membership of the board to act.⁶⁷

Those who are disqualified from participating in the decision are not counted toward the quorum.⁶⁸

However, those who abstain because of a pending question concerning a conflict of interest (for example, an elected official is waiting to receive an advice letter from the FPPC) may be counted toward the quorum. This is because they have not yet been disqualified (typically their agency attorneys will recommend they abstain pending resolution of the conflict issue).⁶⁹

FOR MORE INFORMATION

See the following resources:

- » The FPPC has produced “Recognizing Conflicts of Interest: A Guide to the Conflict of Interest Rules of the Political Reform Act” (2015), available at www.fppc.ca.gov/content/dam/fppc/NS-Documents/LegalDiv/Conflicts%20of%20Interest/Conflicts-Guide-August-2015-Jan-2016-Edits.pdf.
- » “Using Public Office to Promote One’s Business Interests,” available at www.ca-ilg.org/publicoffice.
- » Conflicts of Interest (2010). Explains California’s conflict-of-interest laws available at <http://ag.ca.gov/publications/coi.pdf>.

For specific questions, please contact the Fair Political Practices Commission or agency counsel.

PENALTIES

Political Reform Act Penalties

A refusal to disqualify oneself is a violation of the Political Reform Act. Violations of these laws are punishable by a variety of civil, criminal, and administrative penalties, depending on the severity of the violation and the degree of intent to violate the law that enforcement entities are able to demonstrate.⁷⁰

These penalties can include any or all of the following:

- » Immediate loss of office;⁷¹
- » Prohibition from seeking elected office in the future;⁷²
- » Fines of up to \$10,000 or more depending on the circumstances;⁷³ and
- » Jail time of up to six months.⁷⁴

Effect on Agency and Those Affected by Agency’s Decision

When a disqualified official participates in a decision, a court can void the decision.⁷⁵ This can have serious consequences for those affected by the decision as well as the public agency itself. If someone is encouraging an official to participate in spite of a disqualifying interest, consider pointing out the costs that would occur if the agency’s decision has to be undone—not to mention the legal consequences for the official.

Typically it is wise to err on the side of caution when there is a question regarding the appropriateness of an official’s participation in a matter. When in doubt, sit a decision out.

FOR MORE INFORMATION

On penalties for ethics law violations, see www.ca-ilg.org/consequences.

Interests in Agency Contracts Barred

BASIC RULES

California law strictly forbids public officials from having an economic interest in their agencies' contracts. In essence, this is a prohibition against self-dealing. Now codified in section 1090 of the Government Code, this particular law has been traced back to the earliest days of California's statehood—to 1851.⁷⁶

This prohibition applies to elected and appointed officials as well as public agency employees and consultants.⁷⁷

This means that, if an official has an interest in a contract being contemplated by their agency, the agency may not enter into the contract. If a staff member has an interest in the contract, the staff member may not participate in any way in the contract negotiations or in any part of the development of the contract. Contracts are broadly defined and include employment and a variety of other relationships, including independent contractors.⁷⁸

Key things to keep in mind include the following.

- » **Making a Contract.** The prohibition applies to preliminary discussions, negotiations, planning and solicitation of bids, as well as voting on the contract itself. This means the affected official can't be involved in those as well.
- » **Disqualification Doesn't Fix the Problem.** When the prohibition applies, the agency may not enter into the contract in question. Members of the governing board of a local agency (including a board of supervisors, board of directors, city council or school board members) are deemed to have made any contract executed by the board, or any person or agency under its jurisdiction, even if officials disqualify themselves from participating in the contract.

» **Financial Interest.** A "financial interest" in a contract includes a direct or indirect financial interest. A direct financial interest is present when the official is the party contracting with the agency. An indirect financial interest involves an official who has a financial relationship with the contracting party or will receive some benefit from the making of the contract with the contracting party. For example, the Attorney General has concluded that a trustee of a community college district cannot become employed in any capacity by the district because the trustee would have a financial interest in the employment contract. It does not matter if the official's financial interest is positively or negatively affected. This provision covers financial relationships that go beyond the official's immediate family.

Officials will sometimes hear their agency counsel refer to this issue as a "section 1090 problem," in reference to the Government Code section containing this prohibition. These restrictions on contracts are *in addition* to the restrictions of the Political Reform Act.

A key question to ask oneself in evaluating an agency's contracts is: "will this contract affect my economic interests in any way?" If the answer is "yes," speak with agency counsel immediately.



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FPPC JURISDICTION OVER SECTION 1090 QUESTIONS

The Legislature empowered the FPPC in 2013 to enforce the provisions of section 1090 through either administrative proceedings similar to those it uses for violations of the Political Reform Act or civil actions imposing fines. Prior to commencing such an action, however, the FPPC must obtain permission from the district attorney of the county in which the alleged violation occurred, and the FPPC may not issue opinions related to past conduct. Further, before providing advice, the FPPC must send a copy of the request for advice to the Attorney General and the local district attorney.⁷⁹

The FPPC has developed a six-step analysis to determine whether a violation of section 1090 might occur based on the facts and circumstances presented to the FPPC prior to the action being taken. Those steps are as follows:

- Step 1:** Is the public official in question subject to the provisions of section 1090?
- Step 2:** Does the decision at issue involve a contract?
- Step 3:** Is the official making or participating in making a contract?
- Step 4:** Does the official have a financial interest in the contract?
- Step 5:** Does either a remote interest or a noninterest exception apply?
- Step 6:** Does the “Rule of Necessity” apply?

WHAT IS THE THEORY OF NOT ALLOWING DISQUALIFICATION?

When the prohibition against interests in contracts under section 1090 applies, the agency may not enter into the contract, even if the official with the interest recuses or disqualifies him- or herself. Why? The theory seems to be decision-makers may be favorably influenced to award a contract that benefits a colleague—perhaps with the expectation the favor may be returned in the future. The courts have made clear that the law will assume that undue influence was exerted, and that the risk to the public from self-dealing by public officials is too great to allow anything other than a bright-line, absolute prohibition. The absolute prohibition guards against such a tendency toward what might be described as “you-scratch-my-back-I’ll-scratch-yours” dynamics within the agency.

EXCEPTIONS TO RULES

There are limited exceptions to the general prohibition against interests in contracts.

Non-Interest Exception

Some potential interests in a contract are so small California law classifies them as “non-interests” in a contract. One is when an official receives public services provided by the official’s agency on the same terms that the services are provided to the general public. For example, a member of a water district board may receive water service. In such cases, the official and the official’s agency may participate in the contract. California law provides a full list of exceptions.⁸⁰

Remote Interest Exception

A local agency may enter into a contract when an official has a “remote” interest so long as the official does not attempt to influence another member of the board or council.⁸¹ Government Code section 1091 lists more than a dozen types of remote interests, including:

- » Being an employee of the contracting party, if the contracting party has ten or more employees, the employee began his or her employment at least three years prior to initially assuming office, and certain other requirements are met;⁸² or

- » Being a supplier of goods or services to the party contracting with the agency, when those goods or services have been supplied to the contracting party by the public official for at least five years prior to assuming office.⁸³

Moreover, in 2015, the Legislature passed Senate Bill 704 which added a remote interest exception stating that an official is not financially interested in a contract if he or she is an owner or partner of a firm serving on an advisory board to the contracting agency and the owner or partner recuses himself or herself from reviewing a project that results from a contract between the firm and agency.⁸⁴

If the decision-maker qualifies as having a remote interest, the agency must then take these steps to stay on the right side of the law:

- » The board or council member must disclose the financial interest to the board or council, and disqualify himself or herself from participating in all aspects of the decision;
- » The disclosure must be noted in the official records of the board or council; and
- » The board or council, after such disclosure, must approve, ratify or authorize the contract by a good faith vote of the remaining qualified members of the board or council.⁸⁵

It is important to note that this exception applies only to members of multi-member bodies (not to individual decision-makers and employees).⁸⁶

LIMITED RULE OF NECESSITY

Even if there is not an exception from the prohibition, the agency may still enter into a contract if the rule of necessity applies.⁸⁷ In general, this allows an agency to acquire an essential supply or service. The rule also allows a public official to carry out essential duties of his or her office where he or she is the only one who may legally act. Consult with agency counsel whether the intricacies of this rule may apply in any given situation.

Types of Ethics Laws

SPECIAL RULE FOR SCHOOL DISTRICT BOARDS

California's Education Code specifically allows school board members to vote on collective bargaining agreements and personnel matters that affect a class of employees to which a relative belongs.⁸⁸ Whether this rule also applies to domestic partners is not clear under the statute.

FOR MORE INFORMATION

See the following resources:

- » "How Your Agency Counsel Should Advise You When Agency Contracts Represent a Conflict of Interest," available at www.ca-ilg.org/coi.
- » "Let's Make a Deal: Securing Goods and Services For Your Agency," available at www.ca-ilg.org/procurement.

For specific questions, please contact agency counsel.

PENALTIES

The penalties for violating the prohibition against interests in contracts are severe.

Criminal Penalties

Willful violations are a felony and may be punished by fines of up to \$1,000, imprisonment, and being disqualified from ever holding public office again.⁹¹

Effect on Contract

The contract also is "void," which means the local agency does not have to pay for goods or services received under the contract.⁹² The agency may also seek repayment of amounts already paid.⁹³

FOR MORE INFORMATION

On penalties for ethics law violations, see www.ca-ilg.org/consequences.

Types of Ethics Laws

GETTING ADVICE AND STAYING OUT OF TROUBLE ON CONTRACT ISSUES

As with issues under the Political Reform Act, advice of counsel *does not* provide a defense or immunity in a criminal prosecution relating to unlawful interests in contracts.⁸⁹

As discussed above, the FPPC now has authority to issue advice and opinions on questions involving contracts under section 1090.

The Attorney General will also provide such advice, but only certain kinds of officials are entitled to request an Attorney General opinion.⁹⁰ In addition, the process can take months.

Employment-Related Restrictions

BASIC RULES

Another kind of “personal financial gain” law prohibits elected officials and top-level managers from trading on the relationships developed in public service for their own benefit.

For example, elected officials and chief executives who leave government service must not represent people for pay before their former agencies for one year after leaving their agency.⁹⁴ This is known as a “revolving door” restriction.

In addition, under California’s conflict of interest disqualification rules, a public official may not make or influence agency decisions when the interests of a prospective employer are at stake.⁹⁵ The situation arises when an official is negotiating or has “any arrangement” concerning prospective employment with someone with business before the agency.

FOR MORE INFORMATION

On employment restrictions, see “Revolving Door Restrictions for Local Officials,” available at www.ca-ilg.org/revolvingdoor.

For specific questions, please contact the Fair Political Practices Commission or agency counsel.

WHEN AN EMPLOYEE RUNS FOR A SEAT ON THE GOVERNING BOARD

California law says that, with a few exceptions, local agency employees must resign their employment before taking a seat on the governing board of their local agency.⁹⁶ However, running for an office is not prohibited while employed by a local agency.

This restriction applies to cities, counties, special districts, and other public agencies and corporations.⁹⁷

There are parallel restrictions for employees who run for school boards⁹⁸ and community college district governing boards.⁹⁹ All of the sections note that, if an employee refuses to resign, his or her position will automatically terminate upon being sworn into office on the governing board.¹⁰⁰

These restrictions prevent the dual role conflicts associated with being both in the role of employee and employer.¹⁰¹

PENALTIES

These employment-related restrictions are part of the Political Reform Act. As discussed above, violations of the Act are punishable by a variety of civil, criminal and administrative penalties, depending on the severity of the violation and the degree of intent to violate the law that enforcement entities are able to demonstrate.¹⁰²

These penalties can include any or all of the following:

- » Immediate loss of office;¹⁰³
- » Prohibition from seeking elected office in the future;¹⁰⁴
- » Fines of up to \$10,000 or more depending on the circumstances;¹⁰⁵ and
- » Jail time of up to six months.¹⁰⁶

FOR MORE INFORMATION

On penalties for ethics law violations, see www.ca-ilg.org/consequences.

Endnotes and Additional Information

Note: The California Codes are accessible at <http://leginfo.ca.gov/>. Fair Political Practices Commission regulations are accessible at www.fppc.ca.gov/the-law/fppc-regulations/regulations-index.html. A source for case law information is www.findlaw.com/cacases/ (requires registration).

- 1 Cal. Penal Code §§ 7 (definition number 6), 68(a).
- 2 See Cal. Penal Code §§ 68(a), 86.
- 3 *Id.*; See also *People v. Anderson*, 75 Cal. App. 365, 242 P.2d 906 (1925).
- 4 See 18 U.S.C. § 201.
- 5 See Cal. Penal Code § 518.
- 6 *In re Shepard*, 161 Cal. 171 (1911) (in the context of removal- from-office proceedings for misconduct).
- 7 Cal. Penal Code § 74.
- 8 See generally Cal. Penal Code § 68(a). See also Cal. Elect. Code § 20 (making those convicted of making or receiving a bribe ineligible for public office).
- 9 See Cal. Penal Code § 85.
- 10 Cal. Penal Code § 521.
- 11 Cal. Penal Code § 19.
- 12 Cal. Gov't Code §§ 3060-3074.
- 13 Cal. Penal Code § 74.
- 14 See Cal. Gov't Code § 995.8. See also *Los Angeles Police Protective League v. City of Los Angeles*, 27 Cal. App. 4th 168, 32 Cal. Rptr. 2d 574 (1994) (finding city was not required to provide the defense of police officers accused of vandalism and conspiracy to commit vandalism).
- 15 See Cal. Gov't Code § 995.2(a)(2) (public agency may refuse defense of civil action if, among other reasons, the agency finds the official acted because of "actual fraud, corruption or actual malice.") See also Cal. Gov't Code § 822.2 (immunity from liability for misrepresentation does not apply in instances of corruption).
- 16 See Cal. Gov't Code § 818.
- 17 California Rules of Professional Conduct for Lawyers, Rule 3-600(A); *Ward v. Superior Court*, 70 Cal. App. 3d 23, 138 Cal. Rptr. 532 (1977) (county counsel's client is county, not assessor in his individual capacity).
- 18 18 U.S.C. § 666.
- 19 See 18 U.S.C. §§ 666 (specifying maximum 10-year prison term and fine "under this title"), 3571 (general fine for violating federal criminal laws).
- 20 26 U.S.C. § 7201.
- 21 *Id.*
- 22 26 U.S.C. § 7206(1).
- 23 *U.S. v. Gaytan*, 342 F.3d 1010 (9th Cir. 2003).
- 24 18 U.S.C. §§ 1341 (mail fraud), 1343 (wire fraud), 1346 (honest services).
- 25 *U.S. v. Sawyer*, 239 F.3d 31, 39 (1st Cir. 2001) (finding sufficient evidence of guilt apart from proof of violation of state law).
- 26 *U.S. v. Lopez-Lukis*, 102 F.3d 1164, 1169 (11th Cir. 1997) (noting that effort to improperly control composition of decision- making body constituted an effort to deprive public of honest services); *McNally v. U.S.*, 483 U.S. 350, 362-63 (1987) (Justice Stevens, dissenting).
- 27 See *Skilling v. U.S.*, 130 S.Ct. 2896, 2931(2010) (holding that in order to avoid unconstitutional vagueness, 18 USC § 1346 only criminalizes bribes and kick-back schemes).
- 28 18 U.S.C. §§ 1341 ("... shall be fined under this title or imprisoned not more than 20 years, or both."), 1343 ("shall be fined under this title or imprisoned not more than 20 years, or both.").
- 29 See Cal. Gov't Code §§ 87100-87105.
- 30 2 Cal. Code Regs. § 18707(a)(1)(C).
- 31 2 Cal. Code Regs. § 18700(d).
- 32 Cal. Gov't Code § 87300.
- 33 2 Cal. Code Regs. § 18229.
- 34 Cal. Gov't Code §§ 82030, 87103(c); 2 Cal. Code Regs. §§ 18700, 18700.1.
- 35 Cal. Gov't Code § 87103(c). See also *Larsen Advice Letter*, No. A-82-192 (1982).
- 36 2 Cal. Code Regs. § 18229 (referring to Cal. Gov't Code § 82029 defining "immediate family").
- 37 2 Cal. Code Regs. § 18700.
- 38 Cal. Gov't Code § 87103(b); 2 Cal. Code Regs. § 18700(c)(6)(B).
- 39 2 Cal. Code Regs. § 18229.
- 40 See Cal. Gov't Code §§ 82033, 87103(b).
- 41 2 Cal. Code Regs. § 18229.
- 42 Cal. Gov't Code §§ 82034, 87103(a); 2 Cal. Code Regs. § 18700(c)(6)(A).
- 43 Cal. Gov't Code § 87103(d); 2 Cal. Code Regs. § 18700(c)(6)(D).
- 44 2 Cal. Code Regs. §§ 18700(c)(6)(D), 18700.2(b).
- 45 Cal. Gov't Code § 82033 (pro rata interest, if own 10 percent interest or greater).
- 46 Cal. Gov't Code § 82030(b)(8), (10).
- 47 Cal. Gov't Code §§ 82028, 87103(e); 2 Cal. Code Regs. §§ 18940(c), 18940.2(a)..
- 48 Cal. Gov't Code § 87103(e); 2 Cal. Code Regs. §§ 18940(c), 18940.2(a).
- 49 Cal. Gov't Code § 89503(f).

- 50 See generally Cal. Gov't Code § 87103. See also 2 Cal. Code Regs. § 418700(c)(6)(C), (E).
- 51 See Cal. Gov't Code § 1098(a).
- 52 *Id.*
- 53 See Cal. Gov't Code § 1098(b)
- 54 See generally, 2 Cal. Code Regs. § 18702.2.
- 55 2 Cal. Code Regs. § 18702.2(a)(5).
- 56 2 Cal. Code Regs. § 18703.
- 57 2 Cal. Code Regs. § 18703(b),(c).
- 58 See 2 Cal. Code Regs. § 18707.
- 59 2 Cal. Code Regs. §18707(a)(1)(A).
- 60 2 Cal. Code Regs. §18707(a)(3)(C).
- 61 2 Cal. Code Regs. § 18704(d)(2)(A).
- 62 2 Cal. Code Regs. § 18704(d)(2)(B).
- 63 2 Cal. Code Regs. § 18229.
- 64 2 Cal. Code Regs. § 18704(d)(2)(C).
- 65 See 2 Cal. Code Regs. § 18707(a)(2). See also *Hamilton v. Town of Los Gatos*, 213 Cal. App. 3d 1050, 261 Cal. Rptr. 888 (1989).
- 66 See Cal. Gov't Code § 36810 (for general law cities). See also Cal. Civ. Code § 12; Cal. Civ. Proc. Code § 15.
- 67 See Cal. Gov't Code § 25005; Cal. Educ. Code §§ 35164 (K-12 districts), 72000(d)(3) (community college districts).
- 68 2 Cal. Code Regs. § 18707(a)(1)(C); *Farwell v. Town of Los Gatos*, 222 Cal. App. 3d 711, 271 Cal. Rptr. 825 (1990) (subsequently ordered not published). See also 62 Cal. Op. Att'y Gen. 698, 700 (1979).
- 69 *Farwell v. Town of Los Gatos*, 222 Cal. App. 3d 711, 271 Cal. Rptr. 825 (1990) (subsequently ordered not published). See also 62 Cal. Op. Att'y Gen. 698, 700 (1979).
- 70 See generally Cal. Gov't Code §§ 91000-14.
- 71 See Cal. Gov't Code § 1770(h) (providing a vacancy occurs upon conviction of a felony or of any offense involving a violation of official duties).
- 72 See Cal. Gov't Code § 91002 (providing no person convicted of a misdemeanor under the Political Reform Act shall be a candidate for any elective office or act as a lobbyist for a period of four years following the date of the conviction).
- 73 Cal. Gov't Code § 91000(b). See also Cal. Gov't Code § 83116(c) (providing that the FPPC may impose administrative penalties of up to \$5,000 per violation of the Political Reform Act).
- 74 See Cal. Penal Code § 19 (providing misdemeanors are punishable by imprisonment in county jail up to six months, a fine not exceeding \$1,000, or both).
- 75 See Cal. Gov't Code § 91003(b).
- 76 California Attorney General, Conflicts of Interest, 55 (2010), available at <http://ag.ca.gov/publications/coi.pdf>.
- 77 *Id.*
- 78 See *California Housing Finance Agency v. Hanover/California Management and Accounting Center, Inc.* (2007) 148 Cal.App.4th 682.
- 79 Cal. Gov't Code § 1097.1.
- 80 See Cal. Gov't Code § 1091.5.
- 81 See Cal. Gov't Code § 1091(a), (c).
- 82 See Cal. Gov't Code § 1091(b)(2).
- 83 See Cal. Gov't Code § 1091(b)(8).
- 84 2015 Cal. Stat. ch. 495, § 1 (amending Cal. Gov't Code § 1091).
- 85 See Cal. Gov't. Code § 1091.
- 86 California Attorney General, Conflicts of Interest, 67(2010), available at <http://ag.ca.gov/publications/coi.pdf>.
- 87 See 70 Cal. Op. Att'y Gen. 45 (1987).
- 88 See Cal. Educ. Code § 35107(e).
- 89 *People v. Chacon*, 40 Cal. 4th 558, 53 Cal. Rptr. 3d 876 (2007).
- 90 See Cal. Gov't Code § 12519.
- 91 See Cal. Gov't Code § 1097.
- 92 *Thomson v. Call*, 38 Cal. 3d 633, 214 Cal. Rptr. 139 (1985).
- 93 See Cal. Gov't Code § 1092.
- 94 Cal. Gov't Code § 87406.3; 2 Cal. Code Regs. § 18746.3.
- 95 Cal. Gov't Code § 87407.
- 96 Cal. Gov't Code § 53227(a).
- 97 Cal. Gov't Code § 53227.2(a).
- 98 Cal. Educ. Code § 35107(b)(1).
- 99 Cal. Educ. Code § 72103(b)(1).
- 100 Cal. Gov't Code § 53227(a); Cal. Educ. Code §§ 35107(b)(1), 72103(b)(1).
- 101 *Bd. of Retirement of Kern County Employees' Retirement Ass'n v. Bellino*, 126 Cal. App. 4th 781, 24 Cal. Rptr. 3d 384 (2005).
- 102 See generally Cal. Gov't Code §§ 91000-14.
- 103 See Cal. Gov't Code § 1770(h) (providing a vacancy occurs upon conviction of a felony or of any offense involving a violation of official duties).
- 104 See Cal. Gov't Code § 91002 (providing no person convicted of a misdemeanor under the Political Reform Act shall be a candidate for any elective office or act as a lobbyist for a period of four years following the date of the conviction).
- 105 Cal. Gov't Code § 91000(b). See also Cal. Gov't Code § 83116(c) (providing that the FPPC may impose administrative penalties of up to \$5,000 per violation of the Political Reform Act).
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