



*Everyday Ethics for Local Officials*

## **How Your Agency Counsel Should Advise You When Agency Contracts Represent a Conflict of Interest**

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### **QUESTION**

*We are upset with our new agency counsel. She has advised us to stop purchasing vehicles through our local car dealership, which is owned by one of our elected officials. We are in a remote area, and this dealership is the only one within 20 miles (which is important for servicing vehicles under warranty, for example). Before the dealership opened four years ago, our staff spent a great deal of time traveling to the dealer in the next community to purchase and service cars. And because the dealer is public minded, the agency usually gets a good discount on products and services.*

*Our previous attorney advised us we could purchase the vehicles through the local dealership in light of the practicalities of the situation. We would like our new attorney to follow in this tradition and feel she is being too rigid in her advice. After all, our colleague the car dealer always disqualifies himself from voting on matters relating to vehicle purchases and servicing. Isn't that enough?*

*In fact, isn't an attorney's job to support a client's wishes? Doesn't she have an ethical duty to do so?*

### **ANSWER**

Let's address your question in two parts. The first deals with the laws governing contractual relationships between an agency and those who serve in the agency. The second relates to your attorney's ethical duties.

### **Contractual Conflicts of Interest**

Your attorney is worried about the provisions of a state law that generally prohibit public officials from having a financial interest in a contract entered into by their agency. The prohibition is found in section 1090 of the Government Code.<sup>1</sup> Attorneys sometimes refer to issues that arise in this area as "section 1090 issues."

The goal of the law is to make sure a public official's sole motivation when entering into contracts is the public's benefit - not personal financial interests.<sup>2</sup> Put another way, the goal is to prevent public officials from exploiting their positions for private benefit, also known as self-dealing. As with many ethics laws, even the public's perception that an official might have been motivated by his own financial interests (or his colleagues' interests) must be avoided.<sup>3</sup>

This prohibition applies to elected and appointed officials, as well as public agency employees and consultants. When an individual is a member of a decision-making body, the effect of the prohibition is to prevent the contract from being entered into. Generally, having the interested official disqualify himself is not enough to fix the problem.<sup>4</sup>

## When the Prohibition Applies

The courts and the attorney general have interpreted this prohibition quite broadly.<sup>5</sup> The prohibition goes well beyond situations where there is a formal contract in which your agency agrees to pay one of your elected or appointed officials (or staff) for goods or services.

To give you a sense of just how seriously the courts and the attorney general take this prohibition against self-dealing, consider the following:

- **Providing a discount or advantageous terms to the public agency doesn't help save the arrangement.** Nor does it matter that the contract is intrinsically fair.<sup>6</sup>
- **Merely receiving a financial benefit from a decision can be enough to constitute a financial interest in a contract.** For example, the attorney general concluded the prohibition is violated when a hospital district board decides to reimburse expenses associated with a board member's spouse traveling to a conference (paying such expenses is also considered a gift of public funds).<sup>7</sup>
- **The prohibition applies even when there is only a possibility there will be a financial benefit.** As one court noted, the public is harmed just as much as when a public official acts with a hope of financial gain as when the official is motivated by certain financial gain.<sup>8</sup>
- **Even providing services for free may be prohibited.** The attorney general nixed an arrangement in which an elected official would provide litigation services to his agency for free. The attorney general concluded that, because the elected official would be footing the bill for the litigation, he would still be "financially interested" in the contract.<sup>9</sup>

- **Resigning your position may not help.** The prohibition applies (and a violation of the law occurs) when officials participate even in preliminary discussions, negotiations, planning and specifications for contracts but then resign their positions before entering into the agreement with their agency.<sup>10</sup> The notion is these preliminary activities often define who is eligible to perform the work under the contract or the amount that is paid, so the fact that one resigns before receiving a benefit doesn't avoid the problem.
- **Family relationships can also create issues.** Officials have had section 1090 problems when their agencies propose to do business with firms that employ their spouses.<sup>11</sup>
- **Renewals of pre-existing contractual relationships also can be a problem.** Although it's not a problem if the official has an existing contract with the agency that predates his or her assumption of office, subsequent issues that arise with the contract can be a concern. Things to be alert for are renewals, amendments or assignments of the existing contract.<sup>12</sup>
- **Be aware of situations in which you are part of a string of transactions.** The courts have said it doesn't matter how small or indirect an interest in a contract is; a violation occurs if the official's personal interests deprive the public of an official's overriding fidelity to the public's interests.<sup>13</sup> For example, an elected official got into trouble when his agency approved a development that ultimately resulted in the purchase of his land by a developer (who then conveyed the land to the agency).<sup>14</sup> Similarly, being a creditor of someone who enters into a contract with your agency can be a problem because of your interest in getting the loan repaid.<sup>15</sup>

To make matters more treacherous, the consequences of missteps in this area can be severe. Violation of section 1090 is a crime, punishable by fines and imprisonment. In addition, someone convicted of violating section 1090 not only is a felon but will lose his or her public office and be forever barred from holding California public office again.<sup>16</sup>

The financial consequences of violating section 1090 can also be harsh. The contract is void, which means the public agency can be prohibited from paying for benefits it received under the terms of the contract.<sup>17</sup> In a situation in which a public official had already been paid, a court made the official refund the money he had been paid plus interest.<sup>18</sup>

What's the time limit for challenging a contract as violating this prohibition? For criminal prosecutions, the attorney general advises that the time limit is three years from discovering the violation.<sup>19</sup> In civil actions, the time limit may be four years, and actions to void a contract must be filled within four years of discovering a violation.<sup>20</sup>

If your agency's arrangement with the car dealership violates this prohibition, your colleague may have to refund the money he has been paid for the vehicles your agency purchased and/or had repaired at the dealership for the past four years plus interest. Again, these penalties can be imposed even if the official disqualified himself or stepped aside from participating in the decision to use his dealership.

## Exceptions

There are three categories of exceptions to the prohibition against interests in contracts:

1. **Remote Interests.** This category of exceptions is designed to address situations involving members of decision-making bodies. The notion is that the official does indeed have an interest in a contract, but the interest is sufficiently remote that the public's interests are protected if the official discloses the interest and disqualifies himself from participating in the decision on the contract. Therefore, the agency may enter into the contract.<sup>21</sup>

One example of a "remote interest" situation described in state law is when an official has a contract to provide goods or services to the firm or company that is contracting with the public agency (in other words, is at least one step removed from the contract with the agency). This constitutes a sufficiently "remote interest" only when the official has been a provider of such goods and services for at least five years prior to the official's appointment or election to office.<sup>22</sup> Another commonly invoked remote interest is when the official is an officer or employee of a nonprofit corporation.<sup>23</sup>

2. **Non-Interests.** There is another category of situations the Legislature has decided should not trigger the prohibition. Examples include when an official receives reimbursement for actual and necessary expenses for public service<sup>24</sup> and when a public official receives public services provided by the official's agency in the same manner as everyone else (for example, the official's property receives the same street sweeping services as other properties in the jurisdiction).<sup>25</sup> Under such circumstances, the official can participate in the decision, and usually no disclosure or disqualification is necessary under section 1090. It is important to note, however, your agency counsel may still need to do an analysis under the Political Reform Act to make sure the interest won't require disqualification under other conflict-of-interest laws.
3. **Rule of Necessity.** The attorney general and the courts have also recognized there may be situations in which someone is the only source of a product or service. An example of this is when an agency in a remote area occasionally needed truly emergency service for its vehicles at night and a service station owned by an elected official was the only one open.<sup>26</sup> The other situation in which a "rule of necessity" may apply is when there is only one body or official who can execute the contract.<sup>27</sup>

Your new attorney may be concerned a court would conclude that, because your agency previously had purchased and serviced your vehicles in the next town, it can do so again. Given the risks associated with violating section 1090, your attorney is undoubtedly trying to avoid situations in which your colleague would have to defend himself in a criminal or civil action challenging your agency's arrangement, with all the associated financial consequences that might occur as the result of such a challenge.

## **Encouraging Compliance With the Law**

Your agency attorney's job is to give your agency her best analysis of how to keep out of trouble and on the right side of the line dividing lawful from unlawful conduct. She does this by providing you with advice on how the law applies to situations facing the agency.

It is important to keep in mind, though, that an agency attorney's client is the agency, not individual decision-makers in an agency. Any advice she gives to help individual public officials avoid violations of the law are designed to protect the agency as a whole. Individual officials do not enjoy an attorney-client relationship with the agency's attorney (and conversations with individual officials are not necessarily protected by the attorney-client privilege) because the attorney's client is the agency itself.

How does an attorney determine what the law says? The attorney reads the statutes, case law, attorney general opinions and any other authorities that bear on a given question. She also may consult with other attorneys on a given matter. The fact that your agency has a past practice of engaging in a given activity does not, in and of itself, bear on the analysis.

There are often situations in which the law is not entirely clear (or how a court would apply the law to a given situation is not clear). The attorney can consider good-faith arguments in support of a given analysis or a change in the interpretation of the law, but her basic ethical obligation is to encourage you to follow the law.<sup>28</sup>

In fact, city attorneys encourage each other to resist pressure to be "creative" coming up with questionable legal theories in an effort to provide cover for public officials who want to engage in activity that the attorney believes is unlawful. Nor does it matter that no one is likely to either find out about the situation or challenge it.

## **Counsel's Advice Is No Defense Anyway**

As a practical matter, even if you were successful in persuading your attorney to change her advice to you, there is a significant probability it wouldn't help you if someone challenges the arrangement with your colleague. An elected official found this out the hard way in a recent California Supreme Court ruling when she tried to use her agency attorney's advice as a defense in a criminal prosecution for violating section 1090.

A unanimous court bluntly observed that public officials are trustees and that it is wrong for trustees to engage in self-dealing. As a result, the court concluded it would not allow officials to defend themselves by claiming they relied on their agency attorney's advice. In fact, the court concluded such a defense is antithetical to the strong public policy of strict enforcement of conflict-of-interest statutes.<sup>29</sup>

The case arose from a situation in which a city council voted to appoint one of its members as the city manager. The district attorney filed criminal charges, asserting the appointment violated section 1090's proscriptions against self-dealing. One of the defenses in that case is that the city council member-turned-city-manager relied on the city attorney's advice. This ruling follows on earlier cases in which courts refused to cut decision-makers any slack for relying on advice of counsel in these kinds of situations.<sup>30</sup>

The same rule has always applied in enforcement actions under the state's Political Reform Act: Receiving advice from a local agency attorney does not protect an official from becoming the object of a successful enforcement action. The only advice that will protect a public official or candidate is written advice from the Fair Political Practices Commission.<sup>31</sup>

Finally, the courts have also ruled public officials cannot bring a malpractice action against either the public agency or the attorney for claimed erroneous advice.<sup>32</sup> Again, this is because individual officials do not enjoy an attorney-client relationship with the agency's attorney except as agents of the agency; the attorney's client is the agency itself. This means the attorney-client relationship can never be used as a shield against enforcement of laws designed to protect the agency and the public the agency serves.

## Lessons Learned

What does this mean? First, the most prudent approach is to look to agency counsel for advice on how to follow the law, particularly as it relates to ethics laws. It is also important to keep in mind that the dividing line between lawful and unlawful conduct is not always clear. A wise strategy is to avoid even questionable conduct under such circumstances.

Moreover, count yourself fortunate to have an agency counsel who is working hard to keep you out of trouble and situations that could diminish the public's confidence in your agency. She's probably playing the same role in other situations at your agency.

As someone who is concerned about ethics, you can play a positive role by supporting staff who have the courage to deliver unwelcome but well thought-out advice (what one commentator called "speaking truth to power"). Encouraging your staff to do this is an important part of what you can do as a leader to foster an overall culture of ethics within your agency.

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On this article, ILG is grateful for the input of Lynn Tracy Nerland, city attorney, Antioch; Betsy Strauss, special counsel, League of California Cities; Buck Delventhal, deputy city attorney, San Francisco; Phil Kohn, city attorney, Laguna Beach and Irvine; Stephanie Atigh, city attorney, Hollister; Brian Libow, city attorney, San Pablo; Pamela Thompson, city attorney, San Bruno; Nancy Diamond, city attorney, Arcata; Claudia Culling, senior assistant city attorney, Los Angeles; Helene Leichter, assistant city attorney, Santa Clara; and Joe Pannone, Aleshire and Wynder.

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## Endnotes:

<sup>1</sup> That section reads as follows:

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. Nor shall state, county, district, judicial district and city officers or employees be purchasers at any sale or vendors at any purchase made by them in their official capacity. As used in this article, "district" means any agency of the state formed pursuant to general law or special act for the local performance of governmental or proprietary functions within limited boundaries.

<sup>2</sup> *Thomson v. Call*, 38 Cal. 3d 633, 649, 214 Cal. Rptr. 139, 148 (1985), *cert. denied* 474 U.S. 1057, 106 S. Ct. 796 (1986).

<sup>3</sup> *People v. Honig*, 48 Cal App 4<sup>th</sup> 289, 55 Cal. Rptr. 2d 555 (1996).

<sup>4</sup> *Thomson v. Call*, 38 Cal. 3d at 649, 214 Cal. Rptr. at 149.

<sup>5</sup> *People v. Honig*, 48 Cal App 4<sup>th</sup> 289, 55 Cal. Rptr. 2d 555 (1996).

<sup>6</sup> *Capron v. Hitchcock*, 98 Cal. 427, 33 P. 431 (1893).

<sup>7</sup> 75 Cal. Ops. Att'y Gen. 20, 23 (1992).

<sup>8</sup> *People v. Gnass*, 101 Cal. App. 4<sup>th</sup> 1271, 1298, 125 Cal. Rptr. 2d 225, 246 (2002).

<sup>9</sup> 86 Cal. Ops. Att'y Gen. 138 (2003) (noting that financial interest would prevent a city council member from exercising "absolute loyalty and undivided allegiance" to city).

<sup>10</sup> *Millbrae Association for Residential Survival v. City of Millbrae*, 262 Cal. App. 2d 222, 237, 69 Cal. Rptr. 251, 262 (1968).

<sup>11</sup> 78 Cal. Ops. Att’y Gen. 230 (1995) (development agreement with developer could violate section 1090 when council member’s spouse works for law firm that represents developer); 85 Cal. Ops. Att’y Gen. 34 (2002) (senior staff member may not participate in negotiation of development agreement if his spouse works for firm that provides outreach to developer).

<sup>12</sup> *City of Imperial Beach v. Bailey*, 103 Cal. App. 3d 191; 196, 162 Cal. Rptr. 663, 666 (1980); 76 Cal. Op. Att’y Gen. 118 (1993) (approval of renewal, sale or transfer of cable franchise agreement with city council member subject to section 1090).

<sup>13</sup> *People v. Gnass*, 101 Cal. App. 4<sup>th</sup> 1271, 1299, 125 Cal. Rptr. 225, 246 (2002).

<sup>14</sup> *Thomson v. Call*, 38 Cal. 3d at 646, 214 Cal. Rptr. at 146.

<sup>15</sup> *See People v. Watson*, 15 Cal. App. 3d 28, 37, 92 Cal. Rptr. 860, 865 (1971) (harbor commissioner convicted for voting to approve lease of harbor facilities to an enterprise he helped finance).

<sup>16</sup> Cal. Gov’t Code §1097.

<sup>17</sup> Cal. Gov’t Code §1092, 1095.

<sup>18</sup> *Thomson v. Call*, 38 Cal. 3d at 652, 214 Cal. Rptr. at 151.

<sup>19</sup> *See* Office of the Attorney General, Conflicts of Interest (2004) at page 94 (available online at [http://ag.ca.gov/publications/coi\\_2004.pdf?PHPSESSID=7049e805d5f4709184ad06dd04bafdf9](http://ag.ca.gov/publications/coi_2004.pdf?PHPSESSID=7049e805d5f4709184ad06dd04bafdf9)). *See also* Cal. Penal Code §801, 803(c).

<sup>20</sup> *See* Cal. Civ. Proc. Code §343; *Marin Healthcare District v. Sutter Health*, 103 Cal. App. 4<sup>th</sup> 861, 127 Cal. Rptr. 2d 113 (2002); Cal. Gov’t Code §1092(b) (or within four years of when the violation should have been discovered with the exercise of reasonable care).

<sup>21</sup> Cal. Gov’t Code §1091(a).

<sup>22</sup> Cal. Gov’t Code §1091(b)(8).

<sup>23</sup> Cal. Gov’t Code §1091(b)(1).

<sup>24</sup> *See* Cal. Gov’t Code §1091.5(a)(2).

<sup>25</sup> Cal. Gov’t Code §1091.5(a)(3).

<sup>26</sup> 4 Cal. Ops. Att’y Gen. 264 (1944).

<sup>27</sup> 69 Cal. Ops. Att’y Gen. 102, 109 (1986) (school superintendent was the only one who could execute MOU with teachers union even though spouse is teacher).

<sup>28</sup> Ethical Principles for City Attorneys, adopted Oct. 6, 2005 by the City Attorneys Department of the League of California Cities (see Principle 1-Rule of Law).

<sup>29</sup> *People v. Chacon*, 40 Cal. 4<sup>th</sup> 558, 53 Cal. Rptr. 3d 876 (2007).

<sup>30</sup> *See Thomson v. Call*, 38 Cal. 3d at 650-51, 214 Cal. Rptr. 149-50.

<sup>31</sup> Cal. Gov't Code § 83114(b); 2 Cal. Code of Regs. §18329.

<sup>32</sup> *Chapman v. Superior Court*, 130 Cal. App. 4<sup>th</sup> 261, 29 Cal. Rptr. 3d 852 (2005).