

Office of the City Attorney - Neighborhood Council Advice Division

STATE AND CITY CONFLICT OF INTEREST LAWS: INFORMATION FOR BOARD MEMBERS OF NEIGHBORHOOD COUNCILS

Conflict of Interest Laws Governing Neighborhood Councils

Board members of Neighborhood Councils who are given governmental decision-making authority, must comply with the following conflict of interest laws: The Political Reform Act of 1974, as amended (Government Code § 81000, *et seq.*), Government Code § 1090 *et seq.*, and the common-law conflict of interest rules. Because of the enactment of Ordinance No. 176477,¹ Neighborhood Councils are not required to have a conflict of interest code, required to fill out the state (Form 700) disclosure statement and no longer are subject to the City's Governmental Ethics Ordinance (Los Angeles Municipal Code § 49.5.1 *et seq.*) However, compliance with state and common law conflict of interest laws is still required. A brief explanation of these laws follows.

The Political Reform Act.

The Political Reform Act is a state law that sets up rules and regulations to ensure that governmental officials are free from bias caused by their own financial interests and act in an impartial matter.

Basic Prohibition. Under the Act, public officials are disqualified from participating in government decisions in which they have a financial interest. There are five basic tests to ascertain whether a neighborhood council board member might have a financial interest under the Act. When all of the following are true, the board member would have a disqualifying interest:

- the neighborhood council board member makes, participates in making, or uses his or her official position to influence the making of a decision;
- the neighborhood council board member has a statutorily defined economic interest (his or her own finances or those of members of his or her immediate family, investment in a business, interest in real property, source of income or gifts, management position in a business) that may be affected by the decision;
- it is reasonably foreseeable that the decision will have a *material financial effect* on the neighborhood council board member's economic interest;
- the decision will affect the neighborhood council board member's economic interest in a way that is distinguishable from its effect on the public generally or a significant segment of the public.

See, Los Angeles Administrative Code § 2.20.1

A neighborhood council board member who is disqualified must abstain from making, participating in making or attempting to use his or her official position in any way to influence the government decision.

Persons Covered. The Act treats “members of local governmental agencies” as public officials. Public officials who make, participate in the making of, or influence or attempt to influence a governmental decision must comply with the Act’s provisions. Neighborhood Councils are covered by the Political Reform Act because the City Attorney has concluded that Neighborhood Councils are “local governmental agencies” under the Act’s definition. Thus, the City Attorney concluded, if Neighborhood Councils are delegated the authority to make certain “governmental decisions,” such as “hiring of staff, entering into contracts for goods or services” or have control over funds in the City budget then the board members of those Neighborhood Councils would be “public officials” for the purposes of the Act.²

Participation In Decision-Making. Neighborhood Councils are advisory bodies. Their role is to make recommendations to the various City decision-makers, including City boards, commissions, City Council committees and the City Council. City Charter § 907. This role falls within the “make, participate in making, or attempting to influence a government decision” provision of the Act. Since the Neighborhood Councils have been delegated the authority to make “governmental decisions,” as enumerated above, even the board member’s votes on “non-governmental” or purely advisory recommendations will be subject to the conflict-of-interest provisions.³

Economic Interests Covered. What is a financial interest is often complicated and fact-based, but there are basic types of economic interests that the Act covers:

- a business entity in which a neighborhood council board member or his or immediate family, owns an investment or in which the neighborhood council board member is an officer or director or holds a management position in that business entity;
- real property in which a neighborhood council board member or his or her immediate family, owns an interest;
- any person or entity that is a source of income or loans to the neighborhood

² Making *recommendations* as to whether the City should or should not enter into a contract will also trigger the Act’s requirements. In this instance, this means making a recommendation about a *specific* contract which is coming before the City for action or recommending qualifications/specifications for a city contract. Merely advising the City as to whether, for example, the City should pave a certain street or install lighting, which decisions might ultimately result in the City entering into a contract for those services, would not trigger the Political Reform Act requirements for the neighborhood council providing this advice.

³ Thus, a board member who makes “governmental decisions” must also be aware of, and comply with, the disqualification rules even when making a purely advisory recommendation, for example, to a City Council Committee or Area Planning Commission regarding a conditional use permit for a project located within the boundaries of that Neighborhood Council.

council board member or spouse;

- ❑ any person or entity that has given a neighborhood council board member a gift within the last year;
- ❑ a neighborhood council board member's personal expenses, income, assets or liabilities, including those of his or her immediate family.

Business Investments and Business Positions. An investment of **\$2000 or more** in a business entity by a board member, his or her spouse or dependent children is considered an economic interest. If a board member is a director, officer, partner, trustee, employee or holds a position of management in a business entity, that is also considered an economic interest.

Real Property- An investment of **\$2000 or more** in real property by a board member, his or her spouse, dependent children or anyone acting on his or her behalf, is an economic interest.

Sources of Income and Gifts- The receipt by a board member of income of **\$500 or more** from an individual or organization within 12 months prior to the decision in question is an economic interest. Gifts totaling **\$360** or more received from a single source within 12 months prior to the decision is an economic interest.⁴

*Personal Financial Effects-*Expenses, income, assets or liabilities of board members or their immediate family are considered an economic interest if those expenses, income, assets or liabilities are likely to go up or down by **\$250** as a result of the decision at issue.

Once a board member has determined that he or she has an economic interest, the next step is to determine whether the decision will have a direct or indirect impact upon the board member's interest and whether it is reasonably foreseeable that the decision will have a material effect on the board member's economic interest.

Direct v. Indirect Interest. Whether a particular impact is material or not also depends upon whether the economic interest is directly or indirectly affected by the decision.⁵ A direct interest is more likely to create a greater risk of a conflict of interest than an economic interest that is indirectly involved in the decision.

Foreseeability and Materiality. To have a conflict of interest the effect on the board member's economic interest must be foreseeable (in other words, likely to occur) and be considered "material." In other words, a conflict of interest results if a board member can

⁴ Note: The gift limit is adjusted for inflation every two years. Gov't Code § 89503(f).

⁵ For example, if a neighborhood council board member own a business that is subject to a permit or approval about which the Neighborhood Council is making a recommendation, that is a *direct* impact on that economic interest. If a neighborhood council board member owns a business that is located more than 500 feet away from a piece of property that is seeking, for example, to obtain conditional use approval to sell alcoholic beverages about which the Neighborhood Council is making a recommendation, the decision potentially has an *indirect* impact on that economic interest, *i.e.*, the business of the board member.

reasonably predict that his or her decision on a particular matter will have some economic impact (positively or negatively) on his or her economic interest. The Act sets up some basic thresholds to determine whether an economic interest is material:

Business Investments and Business Positions. As a *general* rule, if a decision directly involves a business entity in which the neighborhood council board member has an interest, the board member must disqualify himself or herself. However, if the only interest in the company is less than \$25,000 in stock, the board member may still be able to participate in the decision after a detailed examination of the state's regulations. If the decision indirectly involves a business entity in which the board member has an interest, a decision's impact would be material if, for large companies such as Fortune 500 companies, the impact on the interest would result in an increase or decrease of the business' gross revenue of **\$10,000,000** or more in a fiscal year; or results in the business entity incurring or avoiding additional expenses or reducing or eliminating existing expenses for a fiscal year in the amount of **\$2,500,000**; or results in an increase or decrease in the value of the business entity's assets or liabilities of **\$10,000,000** or more. At the other extreme, for smaller companies the impact is material if the decision would result in an increase or decrease in revenues of **\$20,000** or more or increase or reduce expenses by **\$5000** or more in a fiscal year, or result in an increase or decrease in the value of its assets or liabilities by **\$20,000** or more.⁶

Real Property- If the decision affects a board member's property which is located **within 500 feet** of the boundaries of the property subject to the decision, disqualification from acting is generally required *unless* the decision will have no financial impact on the property. If the board member's property is located **more than 500 feet**, there is a presumption that the decision will not have a material financial effect. However, that presumption can be rebutted by proof that there are specific circumstances that would make it reasonably foreseeable that a financial effect will result from the presumption. Leasehold interests may also implicate the conflict of interest rules and have to be evaluated on a case-by-case basis.

Sources of Income- If the decision will have **any** financial effect upon an individual who is a source of income for the board member and that source is directly involved in the decision, the effect is determined to be material. The most common source is the employer of the board member or spouse. If a board member or his or her spouse owns 10% or more of a business, clients of that business may also be sources of income. However, if the source of income is indirectly involved in the decision, application of the state's regulations on the particular facts of this source is required to determine if the board member has to recuse himself or herself from acting on the matter.

Distinguishable From The Public. Even if a board member's economic interest is foreseeable and material, he or she does not have a legal conflict of interest unless the decision's impact on his or her economic interest is *different* from the general public's impact. In other words, if a board member is participating in a decision on an issue that will affect the general public's financial interests in the same manner as his or her own

⁶ The Political Reform Act also describes the impacts of other businesses that fall *between* these parameters, which are not discussed here.

interests, even though the decision will have a material economic impact on the board member's financial interest, it does not create a conflict of interest. Under this rule, the decision must affect the board member's interest in *substantially the same manner* as the interests of the public. An example of this would be if the City is embarking upon a plan amendment and zone change for a community plan area and a board member's property is subject to a zone change as is every other property within the community plan area. Although the board member's property is directly affected by the zone change, the property is impacted in substantially the same manner as other members of the public since all are being rezoned, so there is no conflict of interest requiring recusal. The state has developed specific percentage and numerical thresholds for determining when a group of people constitute a significant number to make a determination whether a decision affects the public in the same manner.

Decisions Related to Contracts - Government Code § 1090, et seq.

In addition to the requirements of the Political Reform Act, state law contains special rules governing conflicts of interest relating to government contracts. In a letter directed to the General Manager of the Department of Neighborhood Empowerment, the City Attorney concluded that "[a]s members of an advisory body, members of neighborhood councils will be subject to the requirements of § 1090, et seq." See, City Attorney letter dated November 30, 2000. Accordingly, a neighborhood council board member may not be *financially interested in any City contract* that he or she is involved in making. Thus, any participation by a board member in the process by which a contract is developed, negotiated or approved, *including making a recommendation on the contract*, is a violation of Government Code § 1090 if the board member has a financial interest in that contract. **Also, if the board member has a financial interest in a contract, the entire neighborhood council board might not be able act on the matter.** However, there are some interests called "remote interests" which would disqualify a board member but not the entire neighborhood council board. Gov't Code §1090 prohibitions apply to oral as well as written contracts. Financial relationships in a contract would include, but are not limited to: employee of a contracting party, attorney, agent or broker of a contracting party, supplier of goods or services to a contracting party; landlord or tenant to a contracting party; officer, employee or board member of a nonprofit corporation of a contracting party.

Common Law Conflict of Interest Rules

Although Los Angeles City Charter § 222, contains its own conflict of interest provisions based on an "appearance standard," these standards for disqualification are not applicable to neighborhood council board members. However, neighborhood councils are free to develop their own appearance standards and ethics rules in their bylaws.

Furthermore, basic principles of bias and conflict of interest rules that the courts have developed over time (common law) also apply to your decisions even if the statutory rules may allow you to participate in an action. As the Attorney General has concluded, "[t]he common law doctrine against conflicts of interest . . . prohibit public officials from placing themselves in a position where their private, personal interests may conflict with their official duties." 64 Ops. Cal. Atty Gen 795. As put by the court of appeal, "[a] public officer is impliedly bound to exercise the powers conferred on him with diligence and primarily for the benefit of the public." *Noble v. City of Palo Alto* (1928) 89 Cal. App. 47, 51.

This doctrine applies in situations involving both financial *and* nonfinancial interests. This means that simply having a personal relation to the matter could be construed as tainting a board member's decision-making because he or she is perceived to be biased or making the decision based on his or her personal interest, rather than for the good of the public. Thus, neighborhood council board members should always be alert to whether their private interests, whether financial or otherwise, would be enhanced by any particular action they take on an item before them.

Penalties.

Violations of the Political Reform Act and Government Code § 1090 can carry significant penalties.⁷

Violations of the Political Reform Act can result in civil actions, criminal prosecution and/or administrative sanctions, injunctive relief or in some cases, prohibition against holding future elective office, depending upon the nature of the violation and the jurisdiction of the enforcement agency.

Violations of Gov't Code § 1090 are prosecuted as a felony and a conviction could, in addition to the imposition of a criminal fines and potential imprisonment, result in a lifetime ban from holding any public office in the State of California. In addition, contracts that are entered into in violation of this statute are void as a matter of law.

Finally, any person can file suit in civil court alleging violations of the Act.

Identifying Conflicts.

Because severe penalties may apply to a neighborhood council board member for violations of the conflict of interest laws it is important that board members identify their economic interests that may pose potential conflicts. The eight part test set forth earlier should help board members identify what type of economic interests they have.

If a board member has either an economic interest in a decision that requires disqualification or is disqualified due to the application of the "common law doctrine" of a conflict of interest, the board member must disclose the interest which is the subject of the conflict as well as the fact that he or she is disqualifying himself or herself from any participation in the decision. The board member also may not do anything to influence the decision.

If a board member is disqualified from acting on a meeting agenda item and he or she is

⁷ Note: The City Attorney's Office cannot defend or indemnify a board member who is charged, either civilly or criminally, with a violation of either the Political Reform Act or Gov't Code § 1090. In addition, regarding the attorney-client privilege, the privilege applies to confidential communications between the attorney and the client. Although the City Attorney is the legal advisor to the neighborhood council board, the City's client is the municipal corporation, the City of Los Angeles and not to any individual board member. While the City Attorney's Office is willing and able to assist individual neighborhood council board members with legal advice, the advice given may be disclosed to the neighborhood council board and to any other City entity.

present at the meeting, he or she should make a public announcement identifying the economic interest which is the subject of the conflict and the fact that he or she is disqualified from any participation. After announcing the recusal from participation, the board member should excuse himself or herself and leave the room while that item is pending.

Summary.

Any time any City business is before a neighborhood council board member that involves:

- a business in which he or she or a member of his or her family has an investment;
- an entity of which he or she is an officer or director or holds some position of management;
- real property in which he or she or a member of his or her family has an interest;
- a source of income to him or her or a member of his or her immediate family;
- a source of gifts to him or her; or
- any person or entity with which he or she has a relationship other than in his or her capacity as a City official (e.g, a friend, person with whom he or she has a business relationship or an organization in which he or she holds some position of importance),

board members should contact the Department of Neighborhood Empowerment with the pertinent facts, and the Project Coordinator will confer with the City's attorney for advice to assist the board member. ⁸ The information will be communicated either directly from the Office of the City Attorney or through the Department of Neighborhood Empowerment's Project Coordinator, orally or in writing, depending upon the complexity of the board member's inquiry.

You may also seek advice from the Fair Political Practices Commission (FPPC) at their toll free help line at 1-866-ASK-FPPC, or may ask for a formal written opinion. ⁹

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⁸ The Project Coordinator generally will not provide information relating to allegations of conflict of interest matters relating to third persons (persons other than those making the inquiry); only the board member who is concerned about his/her own economic interest should contact the Department. The one exception is that any board member can and should inquire about the ability of its board to enter into a contract that might implicate Gov't Code § 1090.

⁹ Formal written opinions take a minimum of 21 days but *only written advice from the FPPC* provides immunity from prosecution if acting consistent with that advice.