

# CONFLICTS OF INTEREST IN PUBLIC CONTRACTING

[GOVERNMENT CODE SECTION 1090, et seq.]

## Introduction.

This handout discusses the specific conflict of interest concerns that arise when a neighborhood council spends its public funds, enters into a contract, or makes a recommendation regarding a City contract and a board member or committee member on the neighborhood council has a financial interest in that transaction. While other situations, e.g., the neighborhood council making advisory recommendations to the City on specific subjects, may also present conflict of interest concerns,<sup>1</sup> this handout focuses on situations involving contracting or the expenditure of public funds by neighborhood councils under Government Code section 1090 (also referred to as "Section 1090"). In addition, while this handout is prepared for neighborhood councils, the principles set forth herein apply equally to other boards that are subject to this law.<sup>2</sup>

In 2004, the City Attorney issued an opinion stating that Government Code section 1090, et seq., applies to board and committee members serving on the City's certified neighborhood councils. Section 1090 is one of the primary conflict of interest statutes applicable to public servants involved in the public contracting process and is a State law that prohibits public officials, including employees, from making a public contract in their official capacity when those persons also hold a private financial interest in that same contract.<sup>3</sup>

The California Attorney General's office oversees compliance with this law and violations of Section 1090 are subject to civil and criminal penalties. Thus, board and committee members serving on the neighborhood council should become familiar with this law and seek assistance from the Office of the City Attorney whenever such questions arise.

## Purpose.

The purpose of Section 1090 is to discourage self-dealing and ensure that public servants do not have divided loyalties.<sup>4</sup> Section 1090 developed from a body of decisions by the courts in what is referred to as the "common law." In *Thomson v. Call*, the California Supreme Court explained the reasons underlying Section 1090 and stated

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<sup>1</sup> E.g., the California Political Reform Act, common law, City ordinances and, in the case of neighborhood councils, their bylaws and board rules may pertain.

<sup>2</sup> *Government Code* section 1090, a California statute, applies equally to, among others, "city council members", "commissioners", "board members", "officials", and "employees". Herein, reference is alternatively made to such persons to illustrate a point or as discussed in case law.

<sup>3</sup> *Government Code* section 1090 also applies to City Council members, commissioners, officials, and employees.

<sup>4</sup> See, *Breakzone Billiards et al. v. City of Torrance* (2000) 81 Cal. App. 4<sup>th</sup> 1205, 1230 and *Clark v. City of Hermosa Beach* (1996) 48 Cal. App. 4<sup>th</sup> 1152, 1170-1171 [citing, *Noble v. City of Palo Alto* (1928)].

that “no man can faithfully serve two masters whose interests are or may be in conflict ...”<sup>5</sup> The State legislature codified this common law into Section 1090.

Generally, neighborhood council representatives are agents of the people and the constituents they represent. Section 1090 is intended to ensure that “every public officer be guided solely by the public interest rather than personal interest when dealing with contracts in an official capacity.”<sup>6</sup> In interpreting the law, the courts caution public servants that they may not act in their official capacity to *influence* or *participate in* making a public contract when they simultaneously hold a private financial interest in the same contract.<sup>7</sup> The purpose of the conflict of interest laws and the conduct expected of public servants is captured by the California Supreme Court, quoting the U. S. Supreme Court:

“The statute is thus directed not only at dishonor, but also at conduct that tempts dishonor. The broad proscription embodies recognition of the fact that an impairment of impartial judgment can occur in even the most well-meaning people when their personal economic interests are affected by the business they transact on behalf of the Government. To this extent, therefore, *the statute is more concerned with what might have happened in a given situation than with what actually happened.*”<sup>8</sup>

Thus, Section 1090 is also “aimed at avoiding the appearance of impropriety”<sup>9</sup>

### Application of Section 1090.

Specifically, Government Code section 1090 states:

“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.” (Emphasis added.)

This law means that neighborhood council board members cannot be financially interested in any contract *officially* made by that body or board. Under Section 1090, the first determination that must be made is what type of financial interest exists. The type of financial interest that exists will determine what permissible activities are allowed by the person with the financial interest or the neighborhood council board. In general,

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<sup>5</sup> *Thomson*, 38 Cal. 3d at 647-648 [citing, *San Diego v. S.D. L.A.R.R. Co.*, (1872) 44 Cal. 106, 113.

<sup>6</sup> *Id.* at 650.

<sup>7</sup> *Stigall*, 58 Cal 2d 565, 569; *Finnegan*, 91 Cal. App. 4<sup>th</sup> 572, 579 and *People v. Honig* (1996) 48 Cal. App. 4<sup>th</sup> 289, 314.

<sup>8</sup> *Stigall*, 58 Cal 2d 565, 570 *citing U.S. v. Mississippi Valley Generating Co* (1961) 364 U.S. 520. (emphasis added)

<sup>9</sup> *Honig*, 48 Cal.App.4<sup>th</sup> at 314.

if a financial interest exists, the entire board is prohibited from acting on the contract unless a legal exception applies.

There are several exceptions. There is an exception if the financial interest is a “remote interest” under Government Code section 1091. A “remote interest” requires the person with the financial interest to be disqualified from participating in the transaction but, upon disclosure of the financial interest in the neighborhood council’s records, allows the neighborhood council board to enter into the transaction. In addition, there is an exception that exists if the financial interest is deemed a “non-interest” under Government Code section 1091.5. A “non-interest” means that the person with the financial interest may participate in the transaction, as well as the neighborhood council board, if in certain cases an appropriate disclosure is made.

Section 1090 applies to a variety of public officials and employees representing government agencies in California.<sup>10</sup> It “also applies to members of [governmental] advisory bodies if they participate in the making of a contract through their advisory function.”<sup>11</sup> It applies to board members serving on the City’s certified neighborhood councils because these boards spend public funds for their operations through contracts executed by the Department of Neighborhood Empowerment (DONE) for the benefit of neighborhood councils.<sup>12</sup> Moreover, Section 1090 applies to a variety of public contracts, including employment contracts, leases, sales of goods, consulting services, and development agreements. Neighborhood council boards regularly require contracts for their operations, including supplies, office space, and for neighborhood improvement projects. These contracts are executed in compliance with City contracting rules on their behalf.<sup>13</sup> By recommending the approval of a specific contract for services or neighborhood improvements, neighborhood council board members are part of the City’s public contracting process.

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<sup>10</sup> *Stigall*, 58 Cal. 2d 565; *Thomson*, 38 Cal. 3d 633; *Bailey*, 103 Cal. App. 3d 191; [council members]; *Honig*, 48 Cal. App. 4<sup>th</sup> 289 [elected state official]; *City Council of the City of San Diego v. McKinley* (1978) 80 Cal. App. 3d 204 [park board member]; *People v. Sobel* (1974) 40 Cal. App. 3d 1046 [a city employee]; and 46 Ops.Cal.Atty.Gen. 74, (1965) [contractors/consultants who perform a public function].

<sup>11</sup> *Conflicts of Interests*, California Attorney General’s Office (pamp.) 2004, p. 68; 82 Ops.Cal.Atty.Gen. 126 (1999).

<sup>12</sup> Certified neighborhood councils are also referred to herein simply as “neighborhood councils” or “councils”.

<sup>13</sup> Under the Neighborhood Council Funding Program, developed by the DONE, neighborhood council boards vote to approve all expenditures. Currently, under the Neighborhood Council Funding Program, the DONE prepares the appropriate written agreements for the neighborhood councils to ensure compliance with City contracting rules. City departments and agencies do not ordinarily prepare written agreements for purchases valued under \$1,000.00. (*Los Angeles Administrative Code* section 9.5) Certified neighborhood councils, therefore, purchase goods for their operations through their Stored Value Cards or from petty cash disbursements unless goods are obtained directly through the City and its established vendors.

## “Making a Contract” Within The Meaning Of Section 1090.

If a person is prohibited from participating in a transaction under Section 1090, the prohibition applies to the “making of a contract.” Under Section 1090, a contract having been “made” does not simply refer to the point in time when a neighborhood council member or an official approves, or signs the contract.<sup>14</sup> It also includes when a member or an official, in their official capacity, participates during the preliminary stages of the contracting process.<sup>15</sup> That participation can include preliminary discussions, solicitation of bids, negotiations, and directly or indirectly influencing the decision to make a contract.<sup>16</sup> Thus, a neighborhood council board could be prohibited from entering into a contract if a board or committee member was financially interested in the matter and engaged in early negotiations or discussions of the contract.

Mere membership on the board has import.

“California courts have consistently held that a public officer cannot escape liability for a [S]ection 1090 violation merely by abstaining from voting or participating in discussions or negotiations. [Citation.] Mere membership on [a] board or council establishes the presumption that the officer participated in the forbidden transaction or influenced other members of the council. [Citation.]”<sup>17</sup>

Courts have held that,

“[w]here section 1090 applies, it is an absolute bar to a board or commission entering into the prohibited contract. Even if the interested board or commission member abstains from any participation in the matter, [S]ection 1090 applies to prevent fellow board or commission members from being influenced by their colleague. [Citations.]”<sup>18</sup>

Applying this principle to neighborhood councils, a neighborhood council board member with a financial interest who has influenced the board to enter into a contract, for example, cannot avoid a Section 1090 violation by resigning from the board just before it recommends approving the contract, or by not appearing at the meeting where the contract is approved.<sup>19</sup> Again, “[t]he purpose of the prohibition is to prevent a situation where a public official would stand to gain or lose something with respect to the making of a contract over which he could exercise some influence in his official capacity.”<sup>20</sup>

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<sup>14</sup> *Stigall*, 58 Cal 2d at 571; *McKinley*, 80 Cal. App. 3d at 212; *Millbrae Assn. for Residential Survival v. City of Millbrae* (1968) 262 Cal. App. 2d 222, 237.

<sup>15</sup> *Stigall*, 58 Cal 2d at 569.

<sup>16</sup> *Id.* at 571; *Sobel*, 40 Cal. App. 3d at 1052.

<sup>17</sup> *Thomson*, 38 Cal. 3d at 649.

<sup>18</sup> *Thorpe v. Long Beach Community College District* (2000) 83 Cal. App. 4<sup>th</sup> 655, 659.

<sup>19</sup> *Stigall*, 58 Cal.2d 565.

<sup>20</sup> *Id.* (quoting, *People v. Vallerga* (1977) 67 Cal. App. 3d 847, 867-868, fn. 5).

## The Meaning Of “Financially Interested.”

Although Section 1090 is directed at an interest in a contract, the statute does not specifically define the term “financial interest.” Thus, we look at case law to provide further guidance as to the meaning of the term and to understand how the courts have upheld the legislative intent of this statute.

In *City of Imperial Beach v. Bailey*, the court found that a city council member had a conflict of interest due to her ownership of a concession stand (Concession) on a municipal pier, which lease was coming up before the city council for renewal.<sup>21</sup> Council member Bailey had obtained her financial interest in Concession – a bait, tackle and refreshment stand – under an existing lease with the City of Imperial Beach before she became a councilmember. Although the lease came up for renewal after she became a council member, the court found that Section 1090 prohibited Bailey from exercising the “option” to renew the lease while simultaneously serving as a city council member. The court stated that:

“it is conceded that Hazel Bailey’s integrity is above reproach and we sympathize with her position of having to choose between remaining on the Council or continuing as owner of Concession. However, the purpose of [S]ection 1090 is not only to strike at actual impropriety, but to strike at the appearance of impropriety.”<sup>22</sup>

The California Attorney General has identified two unique situations where it found a “financial interest” in a contract: 1) where a public entity board member requested reimbursement for a conference attended by a board member of the spouse and, 2) where a public entity entered into a development agreement with a developer.

Courts have generally agreed with, and have applied, the Attorney General’s analysis when confronted with similar scenarios. For example, the courts have found that “a member of a board or commission *always* is financially interested in his or her spouse’s source of income for purposes of section 1090. This is true even if the husband and wife have an agreement that their own earnings are to be treated as their separate property, since each spouse is liable for the necessities of life for the other [citations omitted].”<sup>23</sup>

And, in *Thomson v. Call*, the California Supreme Court held that Section 1090 was violated where a city council member for the City of Albany sold his land to the city through a third party corporate developer.<sup>24</sup> The developer, Interstate General Corporation (IGC), sought a zone change and use permit to allow denser housing development on property it owned on Albany Hill. As part of IGC’s request, it also agreed to purchase property that it would convey to the City of Albany for a public park.

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<sup>21</sup> *Bailey*, 103 Cal.App.3d 191.

<sup>22</sup> *Id.*, at 197.

<sup>23</sup> 78 Ops.Cal.Atty.Gen. 230 (1995); *Honig*, 48 Cal. App. 4<sup>th</sup> at 319 and *Thorpe*, 83 Cal. App. 4<sup>th</sup> at 659.

<sup>24</sup> 38 Cal. 3d 633.

Councilman Call had such a parcel to sell on Albany Hill and he sold it to IGC. The property was thereafter conveyed by IGC to the City for the park to fulfill the conditions of the zone change approval. Although Call technically sold his property under contract to IGC, not directly to the City, the Court found that section 1090 had been violated. It said “[a]s part of the transaction at issue Call sold his property to the City using IGC as a conduit. Whether we regard his interest as direct or indirect, it is clearly a pecuniary interest forbidden by section 1090 and by the decisions applying conflict-of-interest rules generally.”<sup>25</sup>

Of significance, the benevolent purpose of the transaction – a public park carried no weight with the Court in the *Thomson* case. It found that “if the interest of a public officer is shown, the contract cannot be sustained by showing that it is fair, just and equitable as to the public entity.”<sup>26</sup>

Courts have also found that it does not matter that the financial interest in the contract is immaterial or a small amount for section 1090 to apply. For example, in *People v. Honig*, an elected State official was prosecuted for using his position to steer Department of Education contracts to a non-profit organization employing his wife.<sup>27</sup> The court said that to be “‘financially interested’ in a contract within the meaning of section 1090 does not require that the prohibited interest have a material effect on the public official’s source of income. Any interest, except a remote one, which would prevent the official from exercising absolute loyalty and undivided allegiance to the best interest of the state is prohibited under the statute [citation.]”<sup>28</sup> The court found that the fact that the officer’s interest “might be small or indirect is immaterial so long as it is such as deprives the [state] of his overriding fidelity to it and places him in the compromising situation where, in the exercise of his official judgment or discretion, he may be influenced by personal considerations rather than the public good. [citation]”<sup>29</sup> Indeed, the court added, “the prosecution [did] not have to prove fraud, dishonesty, or loss.”<sup>30</sup>

Another example illustrating a financial interest can be found in *Fraser-Yamor Agency, Inc. v. County of Del Norte*.<sup>31</sup> There, the County (insured) procured insurance from an insurance company (insurer) that was brokered through the Fraser-Yamor Agency, Inc (agency). Fraser, a principal and major shareholder in the agency, also served as a Del Norte County supervisor, the insured. The court found that Fraser held a financial interest in the contract between the County and the insurance company and stated that “[h]is interest in the agency and in any contracts from which it derives a

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<sup>25</sup> 38 Cal.3d at 646.

<sup>26</sup> *Id.* at p. 649; citing, *Capron v. Hitchcock* (1893) 98 Cal. 427 and *Honig*, 48 Cal. App. 4<sup>th</sup> 289, 314.

<sup>27</sup> 48 Cal.App.4<sup>th</sup> at 305-313.

<sup>28</sup> *Id.*, at 328.

<sup>29</sup> *Id.* at 315.

<sup>30</sup> *Id.* at 322.

<sup>31</sup> *Fraser-Yamor Agency, Inc., v. County of Del Norte* (1977) 68 Cal. App. 3d 201.

pecuniary benefit is clearly a financial one because the success of the agency inures to his personal benefit.”<sup>32</sup>

Finally, in *People v. Watson*, a case involving a City of Los Angeles Harbor Commissioner, the court found a financial interest based on a debtor-creditor relationship.<sup>33</sup> This case involved bringing the vessel *S.S. Princess Louise* from Seattle to the Port of Los Angeles to serve as an attraction and a restaurant at the port. Charles Sutton, a local restaurateur, spearheaded the effort and needed to lease space from the Port of Los Angeles to dock the ship. Sutton also sought a liquor license as part of the business. City Harbor Commissioner Watson loaned Sutton’s corporation \$10,400 to acquire a liquor license and, at a commission meeting, Watson voted to approve the Los Angeles port lease to dock the ship.<sup>34</sup> The floating restaurant opened for business in September of 1966 and, thereafter, Sutton repaid the loan.

In affirming Commissioner Watson’s conviction for violation of sections 1090 and 1097, the court appeal upheld the use of the following jury instruction:

“ ‘financially interested’ means any financial interest which might interfere with a city officer’s unqualified devotion to his public duty. The interest may be direct or indirect and includes any monetary or proprietary benefits, or gain of any sort, or the *contingent possibility* of monetary or proprietary benefits.” (Emphasis added/portions omitted)<sup>35</sup>

As it considered Watson’s appeal, the court stated that “[w]e must disregard the technical relationship of the parties and look behind the veil which enshrouds their activities in order to discern the vital facts [citation]. However devious and winding the trail may be which connects the officer with the forbidden contract, if it can be followed and the connection made, a conflict of interest is established.”<sup>36</sup>

As we explain below, however, not every “financial interest” constitutes a prohibited interest that would prohibit a board member or the board from acting on a contract. That statute identifies exceptions that would allow board or board member participation based upon the type of interest held.

## Exceptions.

**Section 1091: Remote Interest.** Section 1091 defines the circumstances when a public board may take action despite the fact that one or more of its members holds a

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<sup>32</sup> *Id.* at 215. [The court left unresolved whether Fraser’s financial interest might be deemed a *remote interest* under section 1091.]

<sup>33</sup> *People v. Watson* (1971) 15 Cal. App. 3d 28.

<sup>34</sup> Although Commissioner Watson’s wife was the putative owner of the engineering company that loaned Sutton the money for the license - he had transferred his interest in the company to her before his appointment to the Board of Harbor Commissioners – Sutton, nevertheless, delivered a check that was endorsed by Commissioner Watson.

<sup>35</sup> 15 Cal.App. 3d at 37.

<sup>36</sup> *Id.* at 37.

financial interest in a contract. These statutorily described circumstances are known as *remote* interests. Section 1091(a) states:

“An officer shall not be deemed to be interested in a contract entered into by a body or board of which the officer is a member ... *if* the officer has only a remote interest in the contract and *if* the fact of the interest is disclosed to the body or board of which the officer is a member and noted in its official records, *and* thereafter the body or board authorizes, approves, or ratifies the contract in good faith by a vote of its membership sufficient for the purpose *without counting the vote of the officer or board member with the remote interest.*”<sup>37</sup> (Emphasis added)

Thus, even if a board member has what is considered a “remote interest,” the board may still enter into the contract so long as any member with a financial interest actively disqualifies him or herself from voting.<sup>38</sup> Section 1091(b) lists 14 types of interests which are statutorily defined as being “remote.” Examples of remote interests that might apply to neighborhood councils would include an officer or employee of a non-profit corporation or a landlord or tenant of a contracting party.

Section 1091(b) also sets forth the way that a council, commission, or board may vote to approve a contract without the participation of its financially interested member. Besides abstaining from any participation in the contracting process, the member with the financial interest must specifically disclose the nature of the conflict and have it noted in the official records if a vote is contemplated at a public meeting.

Applied to neighborhood councils, this would mean that a neighborhood council board is permitted, for example, to recommend approval of a contract with a non-profit corporation when one or more of its board members also serves as “an officer or employee of [the] nonprofit corporation” since the interest involved here is statutorily defined as a *remote* financial interest.<sup>39</sup> The only requirement in this instance is that the board member with the financial interest abstains from participation.

**Section 1091.5: Noninterests.** Section 1091.5 defines the circumstances when a board member’s financial interest is statutorily deemed a “noninterest.” An example of a noninterest that might apply to neighborhood councils would include: “. . . a recipient of public services generally provided by the public body or board of which he or she is a member, on the same terms and conditions as if he or she were not a member of the board.”<sup>40</sup> If a neighborhood council member is found to hold a noninterest, the board member (as well as the entire board) may participate in making the contract.<sup>41</sup>

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<sup>37</sup> *Government Code* section 1091(a). [portion omitted].

<sup>38</sup> *Conflicts of Interests*, California Attorney General’s Office (pamp.) 2004, p. 82.

<sup>39</sup> *Government Code* section 1091(b)(1).

<sup>40</sup> *Government Code* section 1091.5(a)(3).

<sup>41</sup> *City of Vernon v. Central Basin Municipal Water District* (1999) 69 Cal. App. 4<sup>th</sup> 508, 515 (1986); 83 Ops.Cal.Atty.Gen. 246, 247 (2000); 78 Ops.Cal.Atty.Gen. Cal. 362, 369-370 (1995).

## Remedies and Penalties.

Violations of the statute can potentially result in civil remedies and/or criminal penalties.

**Civil Remedies: Government Code section 1092.** Contracts made in violation of any of the provisions of Section 1090 are “invalid” or void.<sup>42</sup> Any payment made by the City on a void contract is recoverable and disbursements and future payments on the contact are not enforceable.<sup>43</sup>

**Criminal Penalties: Government Code Section 1097.** Violations of the provisions of Section 1090 are also “punishable by a fine of not more than one thousand dollars (\$1,000), or by *imprisonment in the state prison,*” and a person can be “*forever barred from holding any office in this state.*”<sup>44</sup> (Emphasis added)

## Conclusion.

Invariably, it is necessary to evaluate the factual circumstances that pertain when a conflict of interest question arises. When answering such questions intuition will rarely suffice. Therefore, neighborhood council board members are encouraged to seek assistance from the City Attorney’s Office to avoid conflict of interest problems.

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<sup>42</sup> *Government Code section 1092; Millbrae Association for Residential Survival*, 262 Cal. App 2d at 236. *Accord, Thompson*, 38 Cal. 3d at 646.

<sup>43</sup> *Government Code section 1095.*

<sup>44</sup> *Government Code section 1097.*