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DATE: May 30, 2003

TO: Honorable Mayor and City Council

FROM: City Attorney

SUBJECT: Legal Representation of Councilmembers and Staff, Reimbursement of Attorney Fees, and Fund-Raising Issues Related to Federal Investigation

MEMORANDUM OF LAW

BACKGROUND

On May 14, 2003, agents from the Federal Bureau of Investigation conducted a search of City Hall offices as part of a criminal investigation involving possible wire fraud, bribery, extortion, and racketeering activity. At the time of this memorandum, very little is known about the facts underlying the ongoing investigation. It is unknown how many City officials and staff are potential subjects, targets, or witnesses in the investigation. Following the search on May 14, 2003, a number of City officials and staff members have been subpoenaed to appear and testify before a federal grand jury. Some City officials and staff members have hired private attorneys to represent their interests during this investigation. Our Office has been asked to respond to several legal questions related to this matter, including questions about legal representation of officials and staff, reimbursement for attorney fees, and fund-raising for legal expenses.

QUESTIONS PRESENTED

1. Is the City required to defend and indemnify officials and staff in relation to a criminal investigation?
2. Is the City required to reimburse officials and staff for attorney fees related to a criminal investigation?

3. May Councilmembers seeking reimbursement of attorney fees from the City participate in the reimbursement decision?
4. May Councilmembers receive donations to pay for attorney fees, and if so, what legal restrictions apply to the acceptance of donations for that purpose?
5. May non-elected City employees receive donations to pay for attorney fees, and if so, what legal restrictions apply to the acceptance of donations for that purpose?

SHORT ANSWERS

1. No. The City is not required to defend or indemnify officials or staff in connection with a criminal investigation or proceeding. However, the City may choose to defend and indemnify officials or staff in connection with a criminal proceeding based upon findings that the official acted within the scope of employment and in good faith, and that the defense or indemnification is in the City's best interests.
At this time, insufficient facts are known about the investigation for the City to be able to make the required findings.
2. No. However, the City may choose to reimburse Councilmembers and staff for attorney fees related to a criminal proceeding, based upon findings that the official or staff member acted within the scope of employment and in good faith, and that the reimbursement is in the City's best interests. At this time, insufficient facts are known about the investigation for the City to be able to make the required findings for reimbursement of attorney fees.
3. No. Councilmembers seeking reimbursement for attorney fees related to a criminal proceeding have a conflict of interest which disqualifies them from participating in the reimbursement decision. Additionally, because of the uncertainty surrounding this investigation, there may be Councilmembers who have a financial interest which disqualifies them from participating in such a decision. Until more facts are made public regarding the investigation, it will not be possible to fully analyze the conflict of interest issues related to this situation, and therefore it will not be possible for the Council to meet to discuss the situation in either open or closed session.
4. Yes. Councilmembers may receive donations to pay for legal expenses. However, when the legal fees are directly related to actions taken in an official capacity, the donations are subject to state and local restrictions on campaign contributions, including the "one account rule," reporting rules, timing restrictions, and contribution limits.

5. Yes. Staff members may receive donations to pay for legal expenses. However, legal defense donations for non-elected staff are subject to the rules related to gift reporting and gift limits.

ANALYSIS

I. City Defense and Indemnification of Officials and Staff Related to a Criminal Proceeding

Under the California Tort Claims Act, the City has a legal obligation to defend and indemnify its employees in a civil lawsuit, when the lawsuit arises out of acts performed by employees in the course and scope of their duties. Cal. Gov't Code § 825. In the case of administrative and criminal proceedings, however, the City has no legal obligation to defend or indemnify its employees. Cal. Gov't Code §§ 995.6, 995.8. In the case of a criminal proceeding, a public entity can provide an employee with a defense on a voluntary basis if:

- (a) the criminal proceeding is brought on account of an act or omission in action or the scope of his employment as an employee of the public entity; and
- (b) the public entity determines that such defense would be in the best interests of the public entity and that the employee or former employee acted, or failed to act, in good faith, without actual malice and in the apparent interests of the public entity.

Cal. Gov't Code § 995.8.

Similarly, in the case of an employee who is a witness in a criminal proceeding, who testifies on behalf of the public agency, the agency is not required to provide a defense, but may do so as a discretionary matter. Cal. Gov't Code § 995.9. The voluntary provision of defense and indemnification to an employee who is a witness is within the discretion of the public agency, and may be based on any relevant factors, including, but not limited to, whether the provision of defense or indemnity would serve the public interest. *Id.*

Insufficient facts are known about the federal investigation to allow the required findings to be made for the discretionary provision of legal representation for involved parties and witnesses. For that reason, the issue cannot be resolved until after the investigation has concluded, and sufficient facts have been made public to support the required findings.

II. Reimbursement of Attorney Fees for Officials and Staff Related to a Criminal Proceeding

In the instant case, some City officials and staff have hired private attorneys to represent their interests. This raises the question of whether the City can reimburse the employees for their

attorney fees. Under the California Tort Claims Act, a public entity may provide for a defense in three ways: (1) with its own attorney, (2) by employing other counsel, or (3) by purchasing insurance which requires the insurer to provide the defense. Cal. Gov't Code § 996.

Reimbursement for attorney fees, therefore, is permissible in a criminal matter, but within the same limitations for providing a defense set out in California Government Code section 995.8. Therefore, reimbursement of fees would require findings that the actions were within the scope of employment and taken in good faith, and that the reimbursement is in the best interests of the City.

The reimbursement of legal fees in this situation results in a personal benefit to the employee, and therefore, raises the issue of whether such a payment is an impermissible gift of public funds pursuant to San Diego Charter section 93. San Diego Charter section 93, which is derived from and is similar to article XVI, section 6 of the California Constitution, provides in relevant part:

The credit of the City shall not be given or loaned to or in aid of any individual, association or corporation; except that suitable provision may be made for the aid and support of the poor.

The courts have recognized an exception to the prohibitions of gifts of public funds and extensions of credit, known as the "public purpose" exception. That exception is based on the theory that if a public purpose is served through the use of public funds, no "gift" has been made even though a private party may benefit from the loan or expenditure. *Board of Supervisors v. Dolan*, 45 Cal. App. 3d 237, 243 (1975); *California Housing Finance Agency v. Elliott*, 17 Cal. 3d 575 (1976).

The determination of what constitutes a public purpose is primarily a matter left to legislative discretion, and the courts generally defer to the legislative body in reviewing the exercise of the discretion. *Schettler v. County of Santa Clara*, 74 Cal. App. 3d 990, 1005 (1977). The concept of public purpose has been liberally construed by the courts, and the City Council's finding on that issue will be upheld unless it is determined to be arbitrary. *Atlantic Richfield Co. v. County of Los Angeles*, 129 Cal. App. 3d 287, 298 (1982).

In the case of reimbursement of attorney fees for City employees involved in the current federal investigation, reimbursement cannot be made unless findings are made or it is otherwise established that the employees acted within the scope of employment and in good faith, and that the reimbursement is in the best interests of the City. Under those circumstances, it can be argued

that a public benefit results from the reimbursement. One court interpreting the defense and indemnification provisions of the California Tort Claims Act noted that the purpose of those requirements is to avoid dampening the ardor of employees who might otherwise be preoccupied with the possibility of having to personally finance and pay large judgments in tort suits arising from the performance of their duties. *Johnson v. State of California*, 69 Cal. 2d 782, 792 (1968). Therefore, a decision to provide reimbursement of attorney fees related to the federal

investigation should be postponed until sufficient facts have been made public to allow the required findings to be made.

III. Disqualification of Councilmembers Seeking Reimbursement of Attorney Fees from Participating in the Reimbursement Decision

The discretionary decision and findings regarding reimbursement of attorney fees for City employees involved in the federal investigation must be made by the City Council, as the governing body of the City. This raises the question of whether City Councilmembers involved in the investigation who are seeking such reimbursement have a conflict of interest that disqualifies them from participating in the findings and decision. The authorities relevant to this question are the Political Reform Act, California Government Code sections 81000 – 91015, and California Government Code section 1090.

A. Political Reform Act

The Political Reform Act of 1974 [Act], codified at California Government Code sections 81000–91015, was adopted to ensure that public officials perform their duties in an impartial manner, free from bias caused by their financial interests. Cal. Gov't Code § 81001. For purposes of the Act, a public official has a disqualifying financial interest in a decision if it is reasonably foreseeable that the decision will have a material financial effect, distinguishable from its effect on the public generally, on the official, a member of his or her immediate family, or on any of the economic interests delineated in California Government Code section 87103. Councilmembers seeking reimbursement for attorney fees have two potentially disqualifying interests: (1) a source of income to an official of \$500 or more pursuant to California Government Code section 87103; and (2) an effect on the official's personal finances of \$250 or more. Cal. Code Regs. tit. 2, § 18705.5(a).

There are several provisions in the Act which, for policy reasons, exclude government income from being treated as a disqualifying financial interest for conflict of interest purposes. Salary and reimbursement of expenses received from a government agency are specifically excluded from the definition of “income” for purposes of the Act. Cal. Gov't Code § 82030(a); Cal. Code Regs. tit. 2, § 18232(a). Additionally, the Act provides that an official is not “making or participating in making” a governmental decision when taking actions related to compensation or terms and conditions of employments. Cal. Code Regs. tit. 2, § 18702.4(a)(3).

However, in applying these “government income” exceptions to the provision of attorney fees to an official by a public agency, a distinction is made between a defense and indemnity that is legally required, and a defense and indemnity that is discretionary. The Fair Political Practices Commission has consistently opined in its advice letters that these government income exceptions do not apply to benefits that are not legally required, such as indemnity for punitive damages. *In re Dixon*, FPPC Priv. Adv. Ltr. A-92-227; *In re Gumpert*, FPPC Priv. Adv. Ltr. A-96-245a; *In re Cronin*, FPPC Priv. Adv. Ltr. A-97-579; *In re Romney*, FPPC Priv. Adv. Ltr. A-99-292. The reasoning stated in these advice letters for this distinction is that when an official is legally entitled to defense and indemnity, the official does not have any financial interest in the

outcome of the legal proceeding, and can therefore participate in related decisions. However, when the agency is not required to defend and indemnify the official, the official does have a financial stake in the matter.

It is reasonably foreseeable that the decision to reimburse a Councilmember for attorney fees related to the current investigation will have a material effect on the Councilmember's personal finances of \$250 or more in a twelve month period. Cal. Code Regs. tit. 2, § 18705.5(a). Therefore, the Councilmembers seeking reimbursement of attorney fees related to this investigation are legally disqualified from participating in the reimbursement decision under the Act.

B. California Government Code section 1090

California Government Code section 1090 [Section 1090] precludes a public officer or employee from participating in the making of a contract in which he or she is financially interested. Where the Section 1090 prohibition is applicable, it generally acts as an absolute bar to a multimember board entering into the prohibited contract, even when the interested official abstains from participating in the matter. *Thomson v. Call*, 38 Cal. 3d 633, 649 (1985). Any contract made in violation of Section 1090 is void and cannot be enforced.

The premise underlying Section 1090 is that a person cannot serve two masters simultaneously. *Id.* at 637. Section 1090 is intended to avoid not only actual fraud, but the appearance of impropriety, and to assure that the public agency has its officials' undivided and uncompromised allegiance. *Id.* at 648. For that reason, exceptions to Section 1090 are construed narrowly. *Thorpe v. Long Beach Community College*, 83 Cal. App. 4th 655, 663 (2000).

In the instant situation, the decision to reimburse a Councilmember for attorney fees would involve a contract between the City and Councilmember, whether or not the arrangement is in writing. Because Section 1090 is concerned with the conduct of governmental officials rather than the technical rules governing the making of contracts, a narrow interpretation of Section 1090 would defeat its legislative purpose. *People v. Honig*, 48 Cal. App. 4th 289, 350 (1996). Similarly, although the term "financial interest" is not specifically defined in the statute,

an examination of the case law and the statutory exceptions to the basic prohibition indicates that the term is to be liberally construed. *Thomson v. Call*, 38 Cal. 3d at 645. Members of the City Council have a financial interest in receiving defense and indemnification, or reimbursement for legal expenses, particularly when the provision of these benefits by the City is discretionary, rather than required by law.

Having determined that the Councilmembers have a financial interest, the next step in the analysis is to determine if any of the statutory exceptions to Section 1090 are applicable. One of the exceptions applies to "a person receiving salary, per diem, or reimbursement for expenses from a government entity." Cal. Gov't Code § 1091(b)(13). Another exception applies to a person receiving salary, per diem, or reimbursement for expenses from a government entity, unless the contract directly involves the official's department. *Id.* at 1091.5(a)(9). However, the

application of these “government income” exceptions in relevant cases and Attorney General opinions has been limited to routine and necessary types of compensation and benefits for officials. *Citizen Advocates, Inc. v. Board of Supervisors*, 146 Cal. App. 3d 171 (1983) (car allowance and mileage); *In re Daucher*, 85 Op. Cal. Att’y Gen. 6 (2002) (retirement benefits); *In re Battersby*, 85 Op. Cal. Att’y Gen. 115 (2002) (city salary and benefits). There are no precedents for extension of the government income exceptions to benefits which are not routine and necessary, such as payment of attorney fees in a criminal matter. Further, such an application of those exceptions would not be consistent with the principle that exceptions to Section 1090 are to be construed narrowly. For those reasons, discretionary reimbursement of attorney fees should be treated as a disqualifying financial interest for purposes of Section 1090.

Because all members of a board are assumed to have participated in the making of a contract for purposes of Section 1090, it could be argued that the entire Council is disqualified from participating in this decision, not just the involved Councilmembers. *Thomson v. Call*, 38 Cal. 3d at 633. There is a limited rule of necessity which allows the uninterested members of the board to participate in a decision regarding an essential government function, when the board is the only entity that may legally make the decision. 69 Op. Cal. Att’y Gen. 102 (1986). An essential government function for purposes of this rule has been described as one which must be carried out in order for the agency to perform its mandated statutory duties. 69 Op. Cal. Att’y Gen. 255 n.7 (1986). Here, because the City has no statutory duty to provide defense or reimbursement of attorney fees related to a criminal proceeding, the limited rule of necessity would not be applicable, and the Council cannot meet regarding this issue as long as any of its members are disqualified pursuant to Section 1090.

C. Other Potential Conflict of Interest Issues

In addition to the conflict of interest situation faced by Councilmembers who are requesting reimbursement of attorney fees, and the Section 1090 problem outlined above, there may be other potential conflicts of interest under both the Act and Section 1090 which could disqualify individual Councilmembers or the entire Council from participating in discussions and votes related to this investigation. Councilmembers who are not subjects of the investigation

may be witnesses, and as such may face similar issues related to legal representation and reimbursement. Conflict of interest analysis is fact dependent, and in a situation where the facts underlying the investigation have not been made public, it is impossible to rule out potential conflicts of interests sufficiently to have a quorum for a meeting. For that reason, a meeting to discuss these issues cannot be held until the investigation is complete and sufficient facts have been made public to allow a thorough conflict of interest analysis to be performed.

IV. Restrictions on Donations to Councilmembers for Attorney Fees

Another question that has arisen as a result of this investigation is whether Councilmembers are legally permitted to accept donations to pay for their attorney fees. In general, Councilmembers are permitted to accept donations to pay for attorney fees. However, when the legal proceeding is related to their official status, those donations are subject to all of

the state and local restrictions which apply to campaign contributions, including the “one account” rule, timing restrictions, reporting requirements, and contribution limits.

A. Donation For Legal Defense Related to Official Status is a Contribution

In addition to governing conflicts of interest, the Political Reform Act [Act] regulates limits on gifts and contributions made to candidates¹. The Act defines “contribution” as a payment made at the behest of a candidate or committee, for which full and adequate consideration is not received, “unless it is clear from the surrounding circumstances that it is not made for political purposes.” Cal. Gov't Code § 82015. Additionally, the Act provides that an expenditure of campaign funds for attorney fees is permissible when it is:

[d]irectly related to activities of a committee that are consistent with its primary objectives or arises directly out of a committee's activities or out of a candidate's or elected officer's activities, duties, or status as a candidate or elected officer, including, but not limited to, an action to enjoin defamation, defense of an action to enjoin defamation, defense of an action brought for a violation of state or local campaign, disclosure, or election laws, and an action arising from an election contest or recount.

Cal. Gov't Code § 89514.

Whether a payment for legal defense to a candidate is a gift made for personal purposes or a contribution made for political purposes depends on the particular facts and circumstances of the legal proceeding. Payments for a candidate's or elected official's legal defense have been held to be contributions for political purposes in a number of circumstances, including:

- Defamation action related to a pamphlet circulated during an election claiming the candidate was dishonest. *Thirteen Committee v. Weinreb*, 168 Cal. App. 3d 528 (1985).
- Defense of a federal indictment charging a state senator with racketeering activity for taking money in exchange for official actions. *In re Montoya*, 12 FPPC Ops. 7 (1989).
- Lawsuit by a candidate challenging the outcome of an election. *In re Johnson*, 12 FPPC Ops. 1 (1989).

¹ A candidate includes any individual who receives a contribution or makes an expenditure or gives his or her consent for any other person to receive a contribution or make an expenditure with a view to bringing about his or her nomination or election to any elective office. Cal. Gov't Code § 82007.

- Defense of a judge in a proceeding before the Commission on Judicial Performance. *In re Schmidt*, FPPC Inf. Adv. Ltr. I-90-07.
- Civil or criminal violations arising during the course of official duties (also holding that legal services provided for below market rate are in-kind contributions) *In re Lowell*, FPPC Priv. Adv. Ltr. I-91-323.
- Defense of a complaint filed with the Federal Elections Commission alleging a violation of federal elections law. *In re Bagatelos*, FPPC Priv. Adv. Ltr. A-94-091.

Conversely, it was determined that a donation to a candidate or official for attorney fees was a gift for purely personal purposes in the following circumstances:

- Defense of a charge of falsifying a city government health insurance document.
In re Breitfelder, FPPC Priv. Adv. Ltr. A-95-058.
- Defense against charge of improper use of county staff and resources to benefit a personal law practice. *In re Tooliatos*, FPPC Priv. Adv. Ltr. A-96-118.
- Divorce case. *In re Montoya*, 12 FPPC Ops. 7 (1989).

This summary of opinions illustrates that if the legal proceeding has any reasonable relationship to an individual's official status as a candidate or officeholder, a donation or payment for attorney fees will be deemed to be a contribution made for a political purpose. This holds true even in the case of a criminal proceeding if the charges arose in connection to the defendant's official status. *In re Montoya*, 12 FPPC Ops. 7 (1989). Based upon the few facts that are known about the instant situation, it appears that the investigation is related to actions taken in an official capacity. Therefore, donations to Councilmembers for attorney fees related to the investigation are subject to a number of state and local restrictions on contributions. Some of these restrictions on contributions are discussed in more detail below.

B. "One Account" Rule

One of the consequences of identifying donations for legal defense as contributions is that the donations must be deposited in a single campaign bank account, a requirement known as the "one bank account" rule. Cal. Gov't Code § 85201. Although state law allows candidates for elected state office and elected state officers to have a separate legal defense fund bank account, that provision does not apply to local candidates. *In re Pelham*, 15 FPPC Ops. 1 (2001); *In re Kawagoe*, FPPC Priv. Adv. Ltr. A-02-109; *In re Ross*, FPPC Priv. Adv. Ltr. A-03-040. The *Ross* advice letter was recently issued at the request of the City of San Diego Ethics Commission. In that letter, the Ethics Commission asked for a legal opinion about the City's ability to adopt an ordinance that would allow elected City officials and candidates to establish a separate bank

account for contributions to a legal defense fund. The Fair Political Practices Commission opined that such an ordinance is impermissible because it would conflict with the state law requirement that a candidate may only set up one bank account. *Id.*

C. Timing Restrictions

Although the Political Reform Act does not impose any timing restrictions on the acceptance of contributions, timing restrictions for accepting contributions are applicable to local candidates pursuant to the San Diego Municipal Election Campaign Control Ordinance [ECCO]. San Diego Municipal Code [SDMC] §§ 27.2901 – 27.2974. These timing restrictions derive from the fact that ECCO prohibits campaign fund-raising except in relation to a specific election.

ECCO limits contributions to \$250 per contributor, *per election*. SDMC § 27.2941(a). ECCO recognizes three types of elections: primary, general, and special. SDMC § 27.2903. Campaign fund-raising is prohibited except in relation to a prospective specific election or to a specific past election for purposes of retiring campaign debt. City Att'y MOL No. 98-13 (May 18, 1998); City Att'y MOL No. 98-10 (Apr. 21, 1998). If there is no campaign debt to be paid off and no election pending, then no campaign contributions may be solicited or accepted. City Att'y MOL No. 98-10, at page 6.

D. Contribution Limits

As noted in Section 2 above, SDMC section 27.2941(a) imposes a contribution limit on local candidates of \$250 per individual contributor, per election. This local contribution limit is applicable to contributions for legal defense purposes in the same manner that they apply to contributions for campaign purposes. Thus, an individual who donates \$250 to a candidate for legal defense purposes, in association with a particular election cycle, is precluded from donating

any further money for campaign purposes in association with the same election. The Fair Political Practices Commission has opined on several occasions that campaign contribution limits and reporting requirements apply to contributions made for legal defense purposes. *In re Schmidt*, FPPC Inf. Adv. Ltr. I-90-077; *In re Johnson*, 12 FPPC Ops. 1 (1989), *In re Montoya*, 12 FPPC Ops. 7 (1989). In the *Montoya* opinion, the Commission reasoned that the same restrictions should apply regardless of whether a contribution is for campaign or legal defense purposes, because in both instances there is an equal state interest in preventing corruption or the appearance of corruption. *Id.* at page 4.

V. Restrictions on Donations to Staff for Attorney Fees

Donations for attorney fees given to City staff members who are not candidates for elective office are not contributions, because the term “contribution” is defined specifically as a payment to a candidate. Cal. Gov't Code § 82015. As such, donations for staff members are not subject to the legal restrictions on contributions, such as the “one-account” rule, timing restrictions, and contribution limits. Donations to staff members for attorney fees are subject to a different set of legal restrictions, however, because they are gifts. A gift is any payment that

confers a personal benefit on the recipient, to the extent that consideration of equal value or greater value is not received. Cal. Gov't Code § 82028. A gift also includes a rebate or discount in the price of anything of value, if it is made with regard to official status. *Id.* Therefore, pro bono legal services or discounted legal services provided to City staff may be gifts, if made with regard to the staff member's official status.

The Act imposes restrictions on gifts received by public officials, including a \$340 limit on gifts from a single source in a calendar year, and a gift reporting requirement for gifts aggregating \$50 or more. Cal. Gov't Code §§ 87207, 89503; Cal. Code Regs. tit. 2, § 8940.2. These restrictions apply to City staff members who are public officials for purposes of the Act because they hold positions designated in one of the City's conflict of interest codes. Cal. Gov't Code § 87302.

In order to determine whether the gift rules apply to a particular donation for attorney fees, staff members who are designated filers in a City conflict code must determine if the source of the donation is within their conflict code disclosure category. Donations from sources outside the conflict code disclosure category are not restricted and do not need to be reported. Finally, it should be noted that the only statutory exception to the gift rules which is potentially applicable to donations for legal fees is the exception for gifts from family members. Cal. Gov't Code § 82028(b)(3); Cal. Code Regs. tit. 2, § 18942(a)(3)².

CONCLUSION

The ongoing federal investigation at City Hall presents a number of challenging legal issues related to the representation of officials and staff. The City's legal ability to defend, indemnify, or reimburse attorney fees for officials and staff in relation to this investigation is dependent on facts which are unknown at this time. For that reason, requests for such benefits cannot be addressed until the investigation has been completed, and sufficient facts have been made public to allow the required findings to be made regarding whether the actions in question were within the scope of employment, and whether they were taken in good faith. Councilmembers seeking reimbursement of attorney fees have a conflict of interest which disqualifies them from participating in these decisions, therefore it will be impossible for the Council to meet regarding this issue until sufficient facts are known to allow a complete conflict of interest analysis to take place. Finally, officials and staff receiving donations for attorney fees must comply with state and local restrictions on campaign contributions and gifts.

Our Office will continue to address legal issues associated with this investigation as they arise.

CASEY GWINN,
City Attorney

² Family members included in this exemption are: spouse, child, parent, grandparent, grandchild, brother, sister, parent-in-law, brother-in-law, sister-in-law, aunt, uncle, niece, nephew, or first cousin. Cal. Gov't Code § 82028(b)(3); Cal. Code Regs. tit. 2, § 18942(a)(3).

Honorable Mayor and City Council

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