

MEMORANDUM OF LAW

DATE: May 27, 1993

TO: Larry Grissom, Retirement Administrator

FROM: City Attorney

SUBJECT: Conflict of Interest Issues Related to Evaluation  
of Investment with Food Bank

By memorandum dated April 23, 1993, you requested our evaluation of a potential conflict of interest situation involving two members of the Board of Administration ("Board") of the San Diego City Employees' Retirement System ("SDCERS") related to a potential investment opportunity with Food Bank. I obtained the facts to evaluate this situation from your memorandum, from the documentation presented to the Board at the April Board meeting and from conversations with Board member Victor Ross and Sal Salis of Food Bank.

BACKGROUND FACTS

Food Bank is a nonprofit social service organization which sells food to a variety of homeless shelters and relief organizations. Over the last four years, the volume of food sold by Food Bank has increased from 5 million pounds to 8 million pounds. Over that same period, the yearly operating budget for the organization has increased from \$539,000 to \$775,000.

Food Bank is presently housed in a 20,000 square foot building in the vicinity of Home Avenue and Federal Boulevard. In order to increase capacity and services, Food Bank desires to purchase or build a much larger warehouse, approximately 50,000 to 60,000 square feet in size. The total cost of the warehouse is estimated to be \$2.5 million dollars and the increase in cost to Food Bank for the new structure in taxes, insurance and building maintenance is estimated to be \$70,000 a year.

Sal Salis is chairperson for the Building Committee of Food Bank and has proposed an investment opportunity to SDCERS which would involve SDCERS loaning \$1.5 million dollars to Food Bank toward the construction or purchase of a new warehouse facility.

At the April Board meeting, you informed the Board of this proposal by way of an informational item docketed on the Board's agenda. At that time, Ron Saathoff, a member of the SDCERS Board, disclosed for the record that he is a member of the board

of directors for Food Bank. In addition, another SDCERS board member, Victor Ross, indicated for the record that he provides investment consultant services to Food Bank.

Sal Salis has indicated to me that it was Ron Saathoff who suggested the investment opportunity to him and arranged for an initial meeting to introduce him to Doug McCalla, the financial officer for SDCERS. Victor Ross has provided and continues to provide investment services to Food Bank. However, he has never been consulted by Sal Salis or the Building Committee of Food Bank with respect to the funding or purchase of the warehouse facility which is the subject of the investment proposal to SDCERS.

#### Applicable Law and Analysis

The potential for a conflict of interest always exists when an employee or Board member of SDCERS participates in the making of any contract. Potential conflicts of interest of this nature must be evaluated under two distinct statutory schemes; the Political Reform Act (Government Code sections 87100 et seq.) and Government Code sections 1090 et seq.

##### I. Analysis Under the Political Reform Act of 1974

The Political Reform Act (the "Act") was adopted by the People of the State of California in 1974 and specifies in pertinent part as follows: "No public official at any level of state or local government shall make, participate in making or in any way attempt to use his official position to influence a governmental decision in which he knows or has reason to know he has a financial interest." Government Code section 87100.

There are five necessary elements which must be present to trigger the disqualification of a public officer or employee under the Act. There must be: (1) a governmental decision at hand, (2) the public official must have an identifiable economic interest that might be affected by the governmental decision, (3) it must be reasonably foreseeable that the governmental decision will have a financial effect on one or more of those economic interests, (4) the financial effect must be a material financial effect, and (5) the material financial effect must be one that is distinguishable from the effect on the public generally.

As a practical matter, in analyzing any given set of facts, the threshold issue will always be whether the public officer or employee has an "economic interest" in the contract. Specifically, the Act addresses five kinds of economic interests: (1) investments in business entities, (2) interests in real property, (3) sources of income, (4) holding positions with business entities, and (5) donors of gifts and their agents or intermediaries. Government Code sections 87100 et seq. In the case of each category (except the fourth), the Act specifies the

minimum amount of holdings, income or gifts which must exist before an "interest" is created. With respect to the "sources of income" category, the official has a "financial interest" in any source of income which is either received by or promised to the official and which totals \$250 or more in the twelve (12) months prior to the decision in question. Government Code section 87103(e). The term "business entity," as used in the Act, is defined in Government Code section 82005 and means "any organization or enterprise operated for profit, including but not limited to a proprietorship, partnership, firm, business trust, joint venture, syndicate, corporation or association."

Addressing Ron Saathoff's situation first, there has been no indication to us that Mr. Saathoff owns an investment holding in Food Bank, receives any source of income from Food Bank or has received any gifts from Food Bank. The potential conflict arises solely by virtue of his status as a member of the board of directors of Food Bank. The Act does provide that a public official has an economic interest in any business entity in which he or she is an officer, director, employee, or holds any management position, irrespective of whether he or she has an investment or receives income from the entity. However, as mentioned above, this category of economic interest is limited only to business organizations which operate for profit. As a nonprofit entity, Food Bank falls outside this category. Since Mr. Saathoff does not have an economic interest in Food Bank, further analysis under the Act is not required. He is not precluded by the Act from participating in considering the Food Bank investment proposal.

Turning now to Victor Ross's situation, there is nothing revealed in the facts made available to us to suggest that Mr. Ross owns an investment holding in Food Bank, holds any position of management or control in the organization or has received any gifts from Food Bank. With Mr. Ross, the potential conflict arises by virtue of his relationship as a paid investment consultant to Food Bank. According to Mr. Ross, he "runs the money" for Food Bank, meaning that he earns commissions or fees for investing monies of Food Bank. Food Bank is a source of income to Victor Ross. In the last twelve (12) months, Mr. Ross's firm has earned several thousand dollars in fees and commissions from Food Bank derived in proportion to the amount of money he has invested for the organization.

Because Food Bank is a source of income to Mr. Ross greater than \$250, he qualifies as having an "economic interest" under the Act. Further analysis is thus required. It must be determined whether a decision by SDCERS to invest in Food Bank would have a financial effect upon the economic interest and

whether that effect is a material effect. The regulations promulgated by the Fair Political Practices Commission ("FPPC") give specific guidance in this area.

Under the Act, the effect of a decision is considered material to a nonprofit entity which is a source of income to a public official if:

(e) For an entity whose gross annual receipts are more than \$100,000 but less than or equal to \$1,000,000 the effect of the decision will be any of the following:

(1) The decision will result in an increase or decrease of the entity's gross annual receipts for a fiscal year in the amount of \$50,000 or more.

(2) The decision will cause the entity to incur or avoid additional expenses or to reduce or eliminate existing expenses for a fiscal year in the amount of \$12,500 or more.

(3) The decision will result in an increase or decrease in the value of the entity's assets or liabilities in the amount of \$50,000 or more.

2 Cal. Code of Regs. section 18702.5(e) (1989).

Here, the facts indicate that Food Bank's proposed warehouse would be an asset worth \$2.5 million dollars which would increase costs to the organization by \$70,000 dollars a year. Therefore, it is clear that the economic interest will have a material financial effect upon Food Bank. Moreover, because a decision by SDCERS to loan money to Food Bank affects only Food Bank, there is no question that the financial effect upon Food Bank as a result of the Board's decision is distinguishable from the effect of the decision upon the general public.

In Victor Ross's situation, all five elements are present to trigger his disqualification under the Act with respect to Food Bank's proposal. He appropriately disclosed his conflict of interest at the first opportunity and must now abstain from participating in the Board's evaluation of the investment opportunity.

## II. Analysis Under Government Code Section 1090

Government Code section 1090 precludes a public officer or

employee from participating in the making of a contract in which he or she is financially interested. Although the term "financial interest" is not specifically defined in the statute, an examination of case law and the statutory exceptions to the basic prohibition indicate that the term is to be very liberally construed. See, *Thomson v. Call*, 38 Cal. 3d 633, 645 (1985).

Case law teaches that any contract made in violation of Government Code section 1090 is void, not merely voidable. *People ex rel. State of Cal. v. Drinkhouse*, 4 Cal. App. 3d 931 (1970). This is an important distinction from a conflict of interest established under the Act. Generally speaking, a contract is rendered void even when the contracting body enters into the agreement without the participation of the official who had the conflicting interest. Government Code section 1092. In other words, as related to the Board, an individual Board member's conflict is capable of tainting the entire Board and thus precluding the Board from entering into a contract with the party having the conflict with an individual Board member. However, if the nature of the conflicting interest falls within a statutorily defined category of being a "remote interest," pursuant to Government Code section 1091, the contracting body may enter into the contract so long as the affected official discloses the conflict and disqualifies himself or herself from participation in the making the contract. Lastly, Government Code section 1091.5 defines certain situational exemptions which require the affected official to disclose the conflict but still allows that official to participate in the making of the contract.

Applying the above law to the facts of this situation, it is apparent that Victor Ross has a disqualifiable "remote interest" in the Food Bank proposal and Ron Saathoff has a disclosable "noninterest" in the proposal.

Victor Ross's conflict is specified in Government Code section 1091(b)(6). Section 1091(b)(6) provides that an official is deemed to have a "remote interest" in a contract if his or her relationship with the contracting party is that of an owner, officer, employee, or agent of a firm which renders, or has rendered, service to the contracting party in the capacity of stockbroker, insurance agent, insurance broker, real estate agent, or real estate broker, if these individuals have not received and will not receive remuneration, consideration, or a commission as a result of the contract.

Since Mr. Ross does render investment services to Food Bank but is not being paid for any services related to the acquisition of the warehouse which is the subject of the investment proposal, he squarely falls within the category of "remote interest"

defined in Government Code section 1091(b)(6). Although Mr. Ross's relationship with Food Bank does not preclude the Board from entering into a contract with Food Bank, the Board may only do so if Mr. Ross completely abstains from participating in the making of the contract. Under case law, "participation" in the making of a contract is broadly defined to include preliminary discussions, negotiations, compromises, reasoning, planning, drawing of plans and specifications and solicitation for bids. *Stigall v. City of Taft*, 58 Cal. 2d 565 (1962).

Ron Saathoff's interest in Food Bank's proposal is specified in Government Code section 1091.5(a)(7). Section 1091.5(a)(7) provides that a public officer shall not be deemed to be interested in a contract if his or her interest is that of a nonsalaried member of a nonprofit corporation, provided that such interest is disclosed to the body or board at the time of the first consideration of the contract, and provided further that such interest is noted in its official records. The Attorney General's office has taken the position that the term "member," as used in this section is consistent with the use of that term in Corporation Code section 312 and refers to a member of the board of directors and generally is distinguishable from an officer of a corporation.

By virtue of having disclosed the potential conflict at the April 23, 1993, Board meeting when the proposal was first considered by the Board, Ron Saathoff has established a "noninterest" in the Food Bank proposal. Thus, Mr. Saathoff may participate in the making of a contract with Food Bank.

#### Conclusion

Under the facts of this situation, Victor Ross's relationship as investment consultant to Food Bank is a conflict of interest requiring disqualification under both the Political Reform Act and Government Code section 1090. He must completely abstain from participating in the Board's consideration of Food Bank's investment proposal.

Ron Saathoff's status as a board member of Food Bank does not qualify as an economic interest under the Act. He does have a disclosable "noninterest" under Government Code section 1090, however, having fully disclosed that interest at the first opportunity, we are confident in saying that Mr. Saathoff is now free to fully participate in the Board's consideration of Food Bank's investment proposal.

Please contact me if you have any questions.

JOHN W. WITT, City Attorney

By

Richard A. Duvernay

Deputy City Attorney

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