

MEMORANDUM OF LAW

DATE: February 8, 1995

TO: Councilmember George Stevens

FROM: City Attorney

SUBJECT: Potential Conflict of Interest Arising Out of Part
Ownership of Bail Bond Business

QUESTION PRESENTED

By memorandum dated January 24, 1995, you asked the City Attorney for advice regarding conflicts of interest that may arise out of you or your wife's financial involvement with a bail bond business that your son wishes to operate in The City of San Diego. This memorandum is in response to that request.

SHORT ANSWER

We conclude that nothing in the law prohibits you from becoming financially involved with your son's bail bond business, however, such involvement may trigger disclosure and disqualification requirements under the Political Reform Act. Whether you will be required to disclose your financial involvement in your son's business depends on the nature of your involvement. Whether you will also be disqualified from future governmental decisions will depend on the specific governmental decision before you.

BACKGROUND

The following facts were obtained from your original memorandum dated January 24, 1995, and from Deputy City Attorney Cristie McGuire, who obtained additional information from you over the telephone on January 27, 1995.

Your son has asked that you become a part owner of a bail bond business that he would open and operate in The City of San Diego. You would not participate in the operations of the business. However, you would either co-sign for the bank loan and bonding for the business or you would personally loan the money to your son and become a partner in the business.

You have requested advice regarding whether any of these activities would pose a conflict of interest for you while you serve on the City Council. It is important to note that you are not at this time involved in your son's business and that there is no specific decision before you which could involve a conflict. Therefore, we limit our advice to potential issues that may arise in the future should you decide to assist your son with his business.

ANALYSIS

Your financial assistance with your son's business may raise

several issues under the Political Reform Act ("Act"). The Act was adopted by the People of the State of California in 1974 and is codified beginning with Government Code section 81000.F

Unless otherwise indicated, all citations will be to the California Government Code ("Gov't Code") (Deerings 1989 and Supp. 1992).

The Act is administered by the Fair Political Practices Commission ("FPPC"), which adopts regulations interpreting the Act. These regulations have the force and effect of law.

We have found nothing in the Act or any other law that would prohibit you or your wifeF

For purposes of clarity, the discussion in this memorandum will only refer to your financial involvement with the business. However, the analysis also applies to any interest your wife may have in your son's business. Based on community property principles, any financial assistance your wife provides your son and his business will be imputed to you for purposes of the Act. from financially assisting your son with his business, however, your assistance raises issues under two separate parts of the Act: (1) disclosure and (2) disqualification. Each issue will be analyzed separately below.

I. Disclosure Requirements Under the Political Reform Act

The disclosure requirements of the Political Reform Act are set forth in Government Code sections 87200 through 87210. Elected officials must file an annual Statement of Economic Interests form (Form 721). This form requires disclosure of all earned income, gifts, investments, and interests in real property.

Government Code section 87203 states, in pertinent part, as follows:

Every person who holds an office specified in Section 87200 shall, each year at a time specified by commission regulations, file a statement disclosing his investments, his interests in real property and his income during the period since the previous statement filed under this section or Section 87202. The statement shall include any investments and interest in real property held at any time during the period covered by the statement, whether or not they are still held at the time of filing.

As a member of the San Diego City Council, you are a public official subject to the disclosure requirements of the Act. Co-signing a loan and bond for your son's business, or personally lending him money, may trigger the disclosure requirements for both investments and

income. Each will be addressed below.

A. Disclosure of Investments

Any investment held by yourself or a member of your immediate family (your spouse or dependent children) must be disclosed if it has a fair market value equal to, or greater than, \$1,000. Gov't Code Section 82034. If you or your immediate family have any financial interest in or security issued by a business entity,

Government Code section 82005 defines "business entity" as ". . . any organization or enterprise operated for profit, including but not limited to a proprietorship, partnership, firm, business trust, joint venture, syndicate, corporation or association."

or any partnership or other ownership interest in a business entity, doing business, or planning to do business, in San Diego, you have an investment under the Act. Gov't Code Section 82034.F

The relevant portion of Government Code section 82034 defines investment as follows:

". . . any financial interest in or security issued by a business entity, including but not limited to common stock, preferred stock, rights, warrants, options, debt instruments and any partnership or other ownership interest owned directly, indirectly or beneficially by the public official, or other filer, or his or her immediate family, if the business entity or any parent, subsidiary or otherwise related business entity has an interest in real property in the jurisdiction, or does business or plans to do business in the jurisdiction, or has done business within the jurisdiction at any time during the two years prior to the time any statement or other action is required under this title. No asset shall be deemed an investment unless its fair market value equals or exceeds one thousand dollars (\$1,000).

Your son's bail bond business is clearly a business entity planning to do business in San Diego as recognized by the Act. The issue is whether your involvement, either as a co-signor or as a lender and partner, qualifies as an "investment" subject to disclosure under the Act.

1. Co-signer for Loan and Bond for Son's Business

Whether co-signing for a loan and bond for your son's business is a reportable investment under the Act depends on the value attributed to it. Determining the value of co-signing for a loan and bond for your son's business depends on whether you co-sign as a guarantor or whether you co-sign as a purchaser of the business.

A guarantor is one who promises to answer for the debt of another. Cal. Civil Code Section 2787 (Deerings 1986 and Supp. 1992). If you plan to co-sign as a guarantor, you would have no ownership interest in the business. You would only be agreeing to answer for the debts of the

business should your son be unable to do so.

The FPPC has opined that a public official that acts as a guarantor for a business may have a financial interest in the business subject to disclosure or disqualification if the value of the guaranty equals or exceeds \$1,000. FPPC Priv. Adv. Ltr. I-94-210 (July 15, 1994). The FPPC has ruled that a guaranty is an asset of a business which allows the business to operate without the expense associated with obtaining a commercial bond. *Id.* As such, the economic value of a guaranty may be determined by the amount that a commercial bonding agency would charge to bond that guaranty.^F

Commercial bonding agencies will require a percentage of the potential liability as collateral in addition to the amount charged for the bond. The percent charged will depend on the risk associated with the guaranty. Both collateral and charges would be considered to be the expense associated with obtaining a commercial bond.

Based on the above, if you co-sign for a loan for your son's business as a guarantor only, you have a financial interest in the business. The same analysis applies if you co-sign as a guarantor for the bonding of the business. To determine the value of this interest, a commercial bonding agency would need to be consulted. If such an agency would charge your son's business more than \$1,000 to obtain a commercial bond, then you would have a financial interest in your son's business subject to disclosure under the Act.

Alternatively, if you co-sign for the loan for your son's business and you act as a co-purchaser of the business, you would clearly have an ownership interest within the meaning of the Act. As co-purchaser of the business, you are jointly responsible for the debts of the business and you are also entitled to any profits of the business. If your ownership interest is \$1,000 or greater, you would be required to disclose this interest under the Act.

2. Personal Loan to Son's Business/Partnership

If you lend money to your son's business and become partners in the business, you would have an ownership interest in a business entity subject to disclosure under the Act. Thus, if this ownership interest is \$1,000 or greater, you would have to disclose it. This holds true despite the fact that you would not participate in the operations of the business.

B. Disclosure of Income

The Act also requires public officials to disclose their sources of income. The term "income" as used in the Act includes both gifts and loans. Gov't. Code Section 82030. Depending on the financial arrangement between yourself and your son, you may be required to disclose income that you receive from the business or from repayment of any loans made to the business.

If you chose to become a partner or investor in your son's

business, you will be required to disclose any income you receive as a result thereof. In addition, if you personally loan money to your son's business, you will be required to report the repayment of such a loan as income.

In an analogous case, the FPPC has advised that where a public official's son owned a plumbing business as a sole proprietor, both the son and his business were considered sources of income to the official where the official had loaned money to the son's business. FPPC Priv. Adv. Ltr. I-90-384 (August 9, 1990). Based on this advice, you will also have to report the income of your son's business since your son's business would be a source of income to you for the balance of the money you loan the business.

Alternatively, the Act excludes loans among family members from the definition of income. Gov't Code Section 82030(b)(9). The FPPC has advised that repayment of an unsecured loan to a public official by a family member is not reportable. See FPPC Priv. Adv. Ltr. A-94-374 (December 7, 1994). Therefore, if you make a personal loan to your son that is not secured by his business, you would not have to report any loan payments your son makes to you as income.

II. Disqualification Requirements Under the Political Reform Act

The second issue which is of concern to you is whether your assistance with your son's bail bond business, either as a guarantor, lender or partner, may disqualify you from participating in future governmental decisions. In this regard, we can provide you with the general legal principles in the area of disqualification. However, we cannot, absent facts involving a specific governmental decision that is before you, tell you from what decisions you must disqualify yourself. Each decision as to disqualification needs to be made on a case by case basis.

Generally, the Act specifies when economic conflicts of interest prohibit a public official from participating in or making a governmental decision.

Government Code section 87100 states 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.

To determine whether a public official will be required to disqualify himself from participating in a governmental decision depends on examination of four factors:

- (1) Does the public official have an

economic interest that may be affected by that governmental decision?

- (2) If so, will the decision have a reasonably foreseeable, financial effect on that economic interest?
- (3) If so, will the reasonably foreseeable effect be material, thereby creating a disqualifying financial conflict of interest?
- (4) If so, will that financial effect be distinguishable from the financial effect on the public generally, thereby permitting participation in the government decisionmaking despite the conflict?

A. Is there an Economic Interest?

An official has a financial interest within the meaning of Government Code section 87100 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 or a member of his or her immediate family or on:

(a) Any business entity in which the public official has a direct or indirect interest worth one thousand dollars (\$1,000) or more.

(b) Any real property in which the public official has a direct or indirect interest worth one thousand dollars (\$1,000) or more.

(c) Any source of income, other than gifts and other than loans by a commercial lending institution in the regular course of business on terms available to the public without regard to official statutes, aggregating two hundred fifty dollars (\$250) or more in value provided to, received by or promised to the public official within 12 months prior to the time when the decision was made.

(d) Any business entity in which the public official is a director, officer, partner, trustee, employee or holds any position of management.

(e) For purposes of this section,

indirect investment or interest means any investment or interest owned by the spouse or dependent child of a public official, by an agent on behalf of a public official, or by a business entity or trust in which the official, the official's agents, spouse, and dependent children own directly, indirectly, or beneficially a 10-percent interest or greater.

Gov't Code Sections 87103 (a) - (e).

Our previous discussion regarding whether your financial assistance with your son's business is a financial interest subject to disclosure also applies here. Depending on the specific financial agreement between you and your son, you could conceivably have an economic interest for purposes of disqualification under Government Code section 87103(a), (c) or (d). Each will be discussed below.

1. Direct or Indirect Interest in Business Entity
(Gov't Code Section 87103(a))

As discussed previously, if you were to co-sign for a loan or a bond as a guarantor, you would have a financial interest under the Act. If the value of the guaranty was determined to be greater than \$1,000, you would have an interest in a business entity as defined in Government Code section 87103(a) for purposes of disqualification.

Alternatively, if you were to co-sign for a loan or a bond as a co-purchaser, you would have a direct interest in your son's business. If your ownership interest was greater than \$1,000, you would have an economic interest as defined in Government Code section 87103(a).

If you personally loan more than \$1,000 to your son's business, you again would have an economic interest for purposes of disqualification under the Act.

2. Income (Gov't Code Section 87103(c))

If you personally loan money to your son's business, repayment of the loan proceeds, as well as the business income, in the amount of \$250 or more, qualify as an economic interest subject to disqualification under Government Code section 87103(c). See FPPC Priv. Adv. Ltr. I-90-384 (August 9, 1990).

If, on the other hand, you made an unsecured personal loan to your son as opposed to your son's business, the repayment of that loan would not constitute "income" within the meaning of Government Code section 87103(c), and thus repayment of the loan would not subject you to disqualification from City decisions. See FPPC Priv. Adv. Ltr. A-94-374 (December 7, 1994).

3. Partner in Business Entity (Gov't Code Section
87103(d))

If you become a partner in your son's business, you would be deemed to have an economic interest subject to disclosure under Government Code

section 87103(d).

B. Will there be a Reasonably Foreseeable Financial Effect on the Economic Interest?

Assuming that you have an economic interest in your son's bail bond business, you must then determine whether the effect of a governmental decision on that economic interest is reasonably foreseeable. It is reasonably foreseeable if there is a substantial likelihood that it will occur. To be foreseeable, the effect of a decision must be more than a mere possibility; however, certainty is not required. *Downey Cares v. Downey Community Development Co.*, 196 Cal. App. 3d 983, 989-991 (1987). The Act seeks to prevent more than actual conflicts of interest; it seeks to prevent even the appearance of a possible conflict of interest. *Witt v. Morrow*, 70 Cal. App. 3d 817 (1977).

C. Will the Reasonably Foreseeable Effect be Material?

Once you determine that the effect of a decision is reasonably foreseeable, you must determine if the decision has a material financial effect on your interests. Regulation 18702 sets forth the guidelines for determining whether an official's economic interest (that is, interest in real property, business entity, or source of income) in a decision is "materially" affected as required for disqualification under Government Code section 87103.

The extent to which your economic interest is involved in the decision dictates which regulations regarding materiality apply. If your economic interest in the bail bond business is directly involved in the decision, Regulation 18702.1 provides the appropriate standard for materiality. We have attached copies of these regulations for your reference.

However, if your economic interest in the bail bond business will be affected indirectly by a decision, Regulation 18702.2 provides the appropriate standard for determining materiality. We have attached copies of these regulations for your reference.

D. Will the financial effect be distinguishable from the financial effect on the public generally, thereby permitting participation in the decisionmaking despite the conflict?

Finally, even if the reasonably foreseeable financial effect of a government decision is material, disqualification is required only if the effect is distinguishable from the effect on the public generally, or on a significant segment of the public generally. Gov't Code Section 87100; Regulation 18703.

If, after applying the above principles to a specific governmental decision before you, it is concluded that you may participate in the decision under the Political Reform Act, you must still consider your decision under Council Policy 000-4.

III. Council Policy 000-4 -- The City Council's Code of Ethics

In 1967, the City Council adopted a "Code of Ethics" governing elected and appointed officials and employees of the City. Under this policy, "no elected official . . . shall have a financial or other personal interest, direct or indirect, which is incompatible with the proper discharge of his or her official duties or would tend to impair his or her independence or judgment or action in the performance of such duties."

Even though the Political Reform Act may not preclude you from participating in future decisions involving your son's bail bond business, you should also consider whether you will be able to participate in those decisions under the terms of this policy. If, after examining your own conscience, you determine that you can render impartial decisions despite your interest in your son's business, you may vote. If you are not able to stay impartial, you should refrain from participation in the decisions.

CONCLUSION

Nothing in the law prohibits you from financially assisting your son with his bail bond business. However, such assistance is likely to trigger disclosure and disqualification requirements under the Political Reform Act.

Absent the specific terms of the financial agreement between you and your son, we can only advise you as to the consequences of different financial arrangements.

If you co-sign for a loan and bond for your son's business as a guarantor only, you will be required to disclose this investment if the value of the guaranty is \$1,000 or more. If, you co-sign as a co-purchaser, you will also need to disclose this ownership interest if it is \$1,000 or more. If you personally loan your son's business \$1,000 or more, or become partners in the business, you will need to disclose this investment.

Any income you receive from the business, including profits or repayment of loan monies to the business, must be reported. If you loan money to the business, the business income must also be reported by you. However, if you make an unsecured personal loan to your son, you need not disclose as income any payments received from him.

For purposes of disqualification, absent a specific governmental decision before you, we cannot at this time advise you from what decisions to disqualify yourself. Each decision as to disqualification will need to be made on a case by case basis.

If it is determined that you have an economic interest that may be affected by the specific governmental decision, it must then be determined whether such effect will be material and distinguishable from the effect on the public generally.

If the Act does not preclude you from participating in the governmental decision before you, you must still consider whether you can remain impartial as mandated by Council Policy 000-4.

Should you have any further questions regarding this matter or a specific decision that you would like advice on, please feel free to contact me at 236-6220.

JOHN W. WITT, City Attorney

By

Jennifer K. Hooper

Deputy City Attorney

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Attachment

ML-95-12