

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

Conflict of interest laws governing Neighborhood Councils.

Board members of Neighborhood Councils who are given governmental authority, must be mindful of the following conflict of interest laws: The Political Reform Act of 1974, as amended (Government Code § 81000, *et seq.*), Government Code Section 1090 *et seq.*, and the common-law conflict of interest rules. Because the City Council exempted the Neighborhood Councils from being required to adopt a conflict of interest code,¹ Neighborhood Council board members are not required to disclose their financial interests by filing a disclosure statement (Form 700) and are not subject to the City's Governmental Ethics Ordinance (Los Angeles Municipal Code § 49.5.1 *et seq.*). However, compliance with state and common law conflict of interest laws is still required. A brief explanation of these laws follows.

The Political Reform Act.

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

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

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

¹ Los Angeles Administrative Code § 2.20.1

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

Persons covered. The Act treats "members of local governmental agencies" as public officials. Public officials who make, participate in the making of, or influence or attempt to influence a governmental decision must comply with the Act's provisions. Neighborhood Councils have been treated as "local governmental agencies" and board members as "public officials" for the purposes of the Act.²

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

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

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

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

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

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

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

Real property - An investment of **\$2000 or more** in real property by a board member, his or her spouse, or his or her dependent children or anyone acting on his or her behalf, is an economic interest. This includes a leasehold interest other than a month-to-month lease.

Sources of income and gifts - The receipt by a board member or spouse of income of **\$500 or more** from an individual or organization within 12 months prior to the decision in question is an economic interest. Gifts totaling **\$500** or more received from a single source within 12 months prior to the decision is an economic interest.⁴ This gift limit is valid through 2019.

Personal financial effects - Expenses, income, assets or liabilities of board members or their immediate family are considered an economic interest if those expenses, income, assets or liabilities are impacted by **a measurable amount** as a result of the decision at issue.

Once a board member determines that he or she has an economic interest, the next step is to determine whether the interest will be explicitly involved in the decision and whether it is reasonably foreseeable that the decision will have a material effect on the board member's economic interest.

Explicitly Involved and Not Explicitly Involved. Whether a particular impact is material or not also depends upon whether or not the economic interest is explicitly involved in the decision. An interest is generally explicitly involved if the interest is the subject of the decision and as otherwise identified in the state rules. An interest that is not explicitly involved in the decision may still be impacted because of some connection or relation to the decision.⁵ An interest that is explicitly involved in the decision creates a greater risk

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

⁵ For example, if a Neighborhood Council board member owns a business that is subject to a permit or approval about which the Neighborhood Council is making a recommendation, the business is explicitly involved in the decision. If a Neighborhood Council board member owns a business that is located more than 500 feet away from a piece of property that is seeking, for example, to obtain conditional use approval to sell alcoholic beverages about which the Neighborhood Council is making a recommendation, the board's business is not explicitly involved, however, the decision could still impact the board member's economic interest.

of a conflict of interest than an economic interest that is not explicitly involved in the decision.

Foreseeability and materiality. To have a conflict of interest the effect of a decision on the board member's economic interest must be foreseeable and be considered "material." In other words, a conflict of interest results if a board member can reasonably predict that his or her decision on a particular matter will have some economic impact (positively or negatively) on his or her economic interest. Interest in a named party in or the subject of a decision and certain decisions involving real property are deemed to be reasonably foreseeable. If the interest is not explicitly involved in a decision, the financial effect is foreseeable only if the effect can be recognized as a realistic possibility. The rules provide some basic thresholds and factors to determine whether an economic interest is material:

Business investments and business positions- As a *general* rule, if Neighborhood Council board member has an interest in a business that is explicitly involved in the decision, the board member must disqualify himself or herself.

If the business entity is not explicitly involved in the decision, a decision's impact would still be material if (1) the decision may result in an increase or decrease of the entity's annual gross revenues or value of the entity's assets or liabilities in the amount of \$1,000,000 or five percent of the entity's gross revenues and the increase or decrease is at least \$10,000; or (2) the decision may cause the entity to incur or avoid additional expenses or to reduce or eliminate expenses in the amount equal to or more than \$250,000 or one percent of the entity's annual gross revenues and the change in expenses is at least \$2,500; or (3) the official knows or has reason to know that the entity has a real property interest and the property is the subject of the decision or there is clear and convincing evidence the decision would have a substantial effect on the property.

Small Shareholder Exception – If the board member's only interest in the entity is an investment interest of \$25,000 or less and is less than one percent of the entity's shares, disqualification is only required if the decision would have a reasonable foreseeable financial effect to the entity's revenues, assets, liabilities, or expenses referenced in (1) and (2) above or there is clear and convincing evidence that the decision would have a substantial impact on the entity's real property.

Real property - If the decision concerns a property which is located **within 500 feet** of the official's property, disqualification from acting is generally required. If the decision concerns a property which is located **1000 feet or more** of the official's property, disqualification from acting is generally not required unless there is clear and convincing evidence that the official's property will be substantially affected. Additionally, If the decision concerns a property which is located **more than 500 feet, but less than 1,000 feet** of the official's property, disqualification from acting is required if the decision would impact the property's: development potential, income producing potential, highest and best use, market value or character by substantially altering the traffic levels, intensity of use, parking, view, privacy, noise levels, or air

quality. Also, a decision's impact on an official's property is deemed to be material based on six other criteria, including, for example, if the decision applies or amends development criteria or zoning applicable to the official's property or new or improved streets, water, sewer or storm drains that disproportionately benefits or detracts from the property. Impacts on leasehold interests have a different analysis.

Sources of income including gifts - If an individual or entity who is a source of income for the board member and that source is explicitly involved in the decision, the effect is determined to be material. The most common source is the employer of the board member or spouse. If a board member or his or her spouse owns 10% or more of a business, clients of that business may also be sources of income. An exception may apply if the income is from retail sales of a business entity or from a government entity.

If the source of income is not explicitly involved in the decision and is a business entity, the effect is material as described under the section about business entities. If the source of income is an individual, the decision's effect is material if (1) the decision could affect the individual's income, investments, or other assets or liabilities by \$1,000 or more; or (2) the official knows that the individual has an interest in a business that will be financially affected; or (3) the official knows or has reason to know that the individual has an interest in real property that is the subject of the decision or there would be clear and convincing evidence the decision would have a substantial effect on the property. If the source of income is a non-profit entity, the decision's impact is material if (1) the decision may result in an increase or decrease of the organization's annual gross receipts or value of the organization's assets or liabilities in the amount of \$1,000,000 or more or five percent of the organization's annual gross receipts and the annual gross receipts and the increase or decrease is equal to or greater than \$10,000; or (2) the decision may cause the organization to incur or avoid additional expenses or to reduce or eliminate expenses in an amount equal to or more than \$250,000 or one percent of the organization's gross receipts and the change in expenses is equal to or greater than \$2,500 or (3) the official knows or has reason to know the organization has an interest in real property and the property is the subject of the decision as further described in the regulations or there is clear and convincing evidence the decision would have a substantial effect on the property.

The nexus standard may also require disqualification if a decision will achieve, defeat, aid, or hinder a purpose or goal of the source of income and the official or the official's spouse receives or is promised income for achieving the purpose or goal.

Personal Finances - If the board member or the member's immediate family will receive a measurable financial benefit or loss from the decision the impact is material and requires recusal unless the impact is nominal, inconsequential, or insignificant.

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

manner as his or her own interests, even though the decision will have a material economic impact on the board member's financial interest, it does not create a conflict of interest. Under this rule, the decision must affect a significant segment of the public, as defined by the state rules, and the decision must not uniquely affect the member as compared to the public generally.

An example of this would be if the City is embarking upon a plan amendment that impacts all single family residentially zoned property in the City and a board member's property is subject to a zone change as is every other property within the City. Although the board member's property is directly affected by the zone change, the property is impacted in substantially the same manner as other members of the public since all are being rezoned, so there is no conflict of interest requiring recusal. The state has developed specific percentage thresholds for determining when a group of people constitute a significant number to make a determination whether a decision affects the public in the same manner.

Decisions related to contracts - Government Code Section 1090, et seq.

In addition to the requirements of the Political Reform Act, state law contains special rules governing conflicts of interest relating to government contracts. A Neighborhood Council board member may not be *financially interested* in *any City contract* (including a Neighborhood Purposes Grant) that he or she is involved in making. Thus, any participation by a board member in the process by which a contract is developed, negotiated or approved, *including making a recommendation on the contract*, is a violation of Government Code Section 1090 if the board member has a financial interest in that contract. **Also, if the board member has a financial interest in a contract, the *entire* Neighborhood Council board might not be able act on the matter.**

However, there are some interests called "remote interests" which would disqualify a board member but not the entire Neighborhood Council board. Government Code Section 1090 prohibitions apply to oral as well as written contracts. Financial relationships in a contract would include, but are not limited to: employee of a contracting party, attorney, agent or broker of a contracting party, supplier of goods or services to a contracting party; landlord or tenant to a contracting party; officer, employee or board member of a nonprofit corporation of a contracting party. This topic is discussed in greater detail in a later section of this Manual.

Common law conflict of interest rules.

Basic principles of bias and conflict of interest rules that the courts have developed over time (common law) also apply to Neighborhood Council decisions even if the statutory rules may allow a board member to participate in an action. As the Attorney General has concluded, "[t]he common law doctrine against conflicts of interest ... prohibit public officials from placing themselves in a position where their private,

personal interests may conflict with their official duties." 64 Ops. Cal. Atty Gen 795. As stated by the court of appeal, "[a] public officer is impliedly bound to exercise the powers conferred on him with diligence and primarily for the benefit of the public." *Noble v. City of Palo Alto* (1928) 89 Cal. App. 47, 51.⁶

This doctrine applies in situations involving both financial *and* nonfinancial interests. This means that simply having a personal relation to the matter could be construed as tainting a board member's decision-making because he or she is perceived to be biased or making the decision based on his or her personal interest, rather than for the good of the public.

However, having general personal views and opinions about a matter is generally not sufficient to show bias. *Andrews v. Agricultural Labor Relations Board* (1981) 28 Cal. 3d 781. The mere appearance of bias is generally not sufficient for disqualification; but a disqualifying bias may be found if a showing can be made that a public officer has a specific prejudice against a person affected by a decision or a showing that a public officer's decision making ability is so impaired such that s/he cannot render a decision based on appropriate grounds. *Id.* at 792. Thus, Neighborhood Council board members should always be alert to whether their private interests, whether financial or otherwise, would be enhanced by any particular action they take on an item before them. Although not legally required, Neighborhood Council members should avoid even the appearance of bias to avoid allegations that might cause the integrity of the neighborhood council and its members to be questioned.

Penalties.

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

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

⁶ Although Los Angeles City Charter Section 222, contains its own conflict of interest provisions based on an "appearance standard," these standards for disqualification are not applicable to Neighborhood Council board members. However, Neighborhood Councils are free to develop their own appearance standards and ethics rules in their bylaws.

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

Violations of Government Code Section 1090 can be prosecuted as a felony and a conviction could, in addition to the imposition of a criminal fines and potential imprisonment, result in a lifetime ban from holding any public office in the State of California. In addition, contracts that are entered into in violation of this statute are void as a matter of law. Violations of Section 1090 are also subject to administrative enforcement action and fines by the Fair Political Practices Commission (FPPC).

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

Identifying conflicts and disqualification.

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

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

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

Summary.

Any time any City business is before a Neighborhood Council board member that involves:

- a business in which he or she or a member of his or her family has an investment;
- an entity of which he or she is an officer or director or holds some position of management;
- real property in which he or she or a member of his or her family has an interest;
- a source of income to him or her or a member of his or her immediate family;

- a source of gifts to him or her; or
- any person or entity with which he or she has a relationship other than in his or her capacity as a City official (e.g, a friend, person with whom he or she has a business relationship or an organization in which he or she holds some position of importance),

Board members should contact the City Attorney assigned to his or her Neighborhood Council for advice.⁸ You may also seek advice from the Fair Political Practices Commission (FPPC) at their toll free help line at 1-866-ASK-FPPC.

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⁸ The City Attorney's Office generally will not provide information relating to allegations of conflict of interest matters relating to third persons (persons other than those making the inquiry); only the board member who is concerned about his/her own economic or common law conflict of interest should contact the City Attorney's Office. The one exception is that any board member can and should inquire about the ability of its board to enter into a contract that might implicate Government Code Section 1090.