Navigating Pitfalls Under Government Code Section 1090 When Contracting Consultants

Wednesday, May 2, 2018 General Session; 3:15 – 4:45 p.m.

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NAVIGATING PITFALLS UNDER GOVERNMENT CODE SECTION 1090

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May 2018

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INTRODUCTION

Government Code section 1090, which prohibits public officials and certain government consultants from being interested in a contract in both their official and private capacities, is one of the harshest conflict of interest laws in the United States. A contract made in violation of section 1090 is void ab initio, and courts have required the contracting party to disgorge any benefit obtained through the contract, even when the official abstained from the decision to approve the contract. Section 1090 may be enforced through civil actions brought by government agencies, and in some cases, by taxpayers. The Fair Political Practices Commission has authority to bring a civil action or impose administrative fines for violations of the law, and the Attorney General and district attorneys may also file criminal charges for violations of section 1090. Section 1090 does not discern between a good contract and a bad contract: even if a contract benefits the government agency, if it is made in violation of section 1090, it is void.

Although the Legislature has attempted to ameliorate some of the harshness of the law by adopting exceptions over the years, the courts, the Attorney General, and the Fair Political Practices Commission have continued to give it a broad reading. Most recently, the California Supreme Court held that section 1090 applies to consultants who act as "trusted advisors" to government agencies. And several appellate courts have applied section 1090 to design-build contracts let by school districts because the consultants had been involved in the design phase of the project. In 2016, the Attorney General issued an opinion up-ending years of practice by advising that a contract city attorney could not advise the city regarding a bond issuance because the attorney had a financial interest (in the form of additional fees) in the bond issuance itself, which the Attorney General deemed to be a contract. And the Fair Political Practices Commission has issued numerous advice letters concluding that a consultant who advised a government agency about a project could not be retained by the agency to participate in subsequent phases of the same project, depriving public agencies of the ability to contract with consultants who may have the best experience or offer the best price.

These recent decisions have created a host of challenges for public agencies seeking to obtain the best value for their taxpayer dollars while avoiding challenges that can delay or even derail a project. In this paper, we provide an overview of section 1090 and discuss recent court decisions, Attorney General opinions, and FPPC advice letters, particularly as they apply to consultants and contract city attorneys. Finally, we offer some practice tips for navigating the challenges presented by this unique and unforgiving law.

I. GOVERNMENT CODE SECTION 1090

A. Overview Of The Statute

Government Code section 1090 provides that public "officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members." Cal. Gov't Code § 1090. Any participation, even in

an advisory capacity, by the public official, at any point in time, in the process by which a contract is developed, negotiated, approved, executed, or modified can be a violation of section 1090. *People v. Gnass*, 101 Cal. App. 4th 1271, 1287, n.3, 1292 (2002). Nor does it matter whether the contract involves actual fraud, dishonesty, unfairness, or loss to the government entity, or whether the contract is fair or oppressive. *People v. Honig (Honig)*, 48 Cal. App. 4th 289, 314 (1996). Further, if one member of a board has a financial interest in a contract, the entire board is disqualified from making the decision, even if the interested member does not vote on the contract or participate in discussions before the vote. *Thomson v. Call*, 38 Cal.3d 633, 645, 649-50 (1985).[1]

The following elements are required to prove a violation of section 1090: (1) the official participated in the making of a contract in his or her official capacity; (2) the official had a cognizable financial interest in that contract; and (3) the financial interest does not fall within any of the statutory exceptions for remote or noninterests. *Lexin v. Superior Court*, 47 Cal. 4th 1050, 1074 (2010).

The penalties for violating Government Code section 1090 are severe. A contract made in violation of section 1090 is void and unenforceable. Cal. Gov't Code § 1092(a). As a practical matter, courts have construed this to mean the contracts are *voidable*; a public entity retains the discretion to decline to bring an action to declare the contract void, and instead allow the contract to stand, provided that decision is made by officials who have no financial interest in the contract. *San Bernardino County v. Superior Ct.*, 239 Cal. App. 4th 679, 688 (2015); *compare People ex rel. Harris v. Rizzo*, 214 Cal. App. 4th 921, 951 (2013) (Attorney General has standing to bring suit on behalf of the City of Bell to void illegal contracts benefitting city officials who remained in office when the action was commenced).

If a contract is deemed to be void, a contractor may be required to disgorge any profits flowing from the contract, regardless of whether the violation was intentional. *County of San Bernardino v. Walsh*, 158 Cal. App. 4th 533, 551-52 (2007); *Carson Redevelopment Agency v. Padilla*, 140 Cal. App. 4th 1323, 1336 (2006). The classic case illustrating this harsh application of the law is *Thomson*, 38 Cal. 3d at 652, where a city councilmember sold his property to a private developer, who in turn conveyed the property to the city as part of a development agreement. The councilmember had refrained from any participation in the

[1] The Legislature has created two general categories of exceptions to section 1090. First, the Legislature has created exceptions for "remote interests." Cal. Gov't Code § 1091. These exceptions are applicable only to members of boards or commissions and only if the conflicted member discloses his or her financial interest in the contract to the public agency on the record and abstains from any participation in the making of the contract. Cal. Gov't Code § 1091(a). The Legislature has also created exceptions for "non-interests." Cal. Gov't Code § 1091.5. Individuals may fully participate in contracting decisions in which they have one of the listed "non-interest" exceptions if they comply with the requirements of that section.

council's consideration of the development agreement, on advice of the city attorney. The California Supreme Court nonetheless ordered the councilmember to disgorge the proceeds from the sale ($258,000), while allowing the city to keep the property, in order to provide "a strong disincentive for those officers who might be tempted to take personal advantage of their public offices. . . ." *Id*.; *see also Finnegan v. Schrader*, 91 Cal. App. 4th 572, 583-84 (2001) (ordering general manager of a sanitary district to refund the compensation he had received from the agency because he was a member of the agency's board at the time of his appointment, even though he had recused himself from the decision). Even profits that do not come directly from the public entity's funds are subject to disgorgement if they are the result of an illegal contract under section 1090. *Los Angeles Memorial Coliseum Commission v. Insomniac, Inc.*, 233 Cal. App. 4th 803, 826-27 (2015) (concert promoters subject to disgorgement of profits from ticket sales, but not funds paid for time and effort, where general manager and employee of commission had profited personally by diverting concert revenues to themselves and entities owned by them); *see also County of San Bernadino v. Walsh*, 158 Cal. App. 4th 533, 549 (2007) ("In order to fulfill the fundamental public policy underlying section 1090, the County may obtain a forfeiture of the proceeds of a tainted contract, even when the proceeds were received from a third party rather than the public entity itself.") *Id*.

Violations of section 1090 can be enforced in a civil action brought by the public entity or by a party to the contract. The statute of limitations for bringing such a challenge is *four years* after the contract was executed or the conflict was discovered, whichever comes later. Cal. Gov't Code § 1092(b). A new cause of action accrues with each amendment to the contract. *City of Imperial Beach v. Bailey*, 103 Cal. App. 3d 191, 196-97 (1980). And a public agency may bring suit even after the four year limitations period if its claim is raised in a cross-complaint that relates back to the filing of a complaint on a related subject matter. *California-American Water Co. v. Marina Coast Water District*, 2 Cal. App. 5th at 748, 763-64 (2016).

Two courts have ruled that only the parties to the contract can bring a section 1090 claim, and that taxpayers do not have independent standing to bring such claims. *California-American Water Co.*, 2 Cal. App. 5th at 760; *San Bernadino County v. Superior Ct.*, 239 Cal. App. 4th 679, 684 (2015). The First and Second District Courts of Appeal, however, held more recently that taxpayers do have standing to sue under section 1090. *California Taxpayers Action Network v. Taber Construction, Inc.*, 12 Cal. App. 5th 115, 144-45 (2017); *McGee v. Balfour Beatty Construction, LLC*, 247 Cal. App. 4th 235, 248 (2016).

In addition, a public official found to have committed a knowing and willful violation of section 1090 may be punished by a fine of not more than $1,000 or imprisonment. Cal. Gov't Code § 1097. A convicted public official is forever disqualified from holding any office in the state. *Id*. In *Honig*, 48 Cal. App. 4th 289, 329-30 (1996), for example, the court upheld the criminal conviction of the former state superintendent of public instruction for causing Department of Education funds to be used to pay salaries of a nonprofit organization that employed his wife, even though the funds were not used to pay his wife's salary directly. Statutory amendments added in 2014 also provide for criminal liability for any "individual who willfully aids or abets an officer or person in violating" section 1090. Cal. Gov't Code § 1097(b).

The statute of limitations for criminal prosecutions is three years from the date the offense was committed or discovered. Cal. Penal Code §§ 801, 803(c). The Attorney General or the district attorney in the county in which the violation occurred may prosecute officials for violating section 1090.

It is important to note that reliance upon advice of counsel, actions taken in good faith, and the belief that the contract was in the public's best interest are not defenses to a prosecution under section 1090. *D'Amato v. Superior Ct*., 167 Cal. App. 4th 861, 869 (2008); *see also People* , 48 Cal. App. 4th at 347-48; *Thomson*, 38 Cal. 3d at 646. Equitable defenses such as laches are also generally unavailable to defeat a section 1090 claim. In *Thomson v. Call*, 38 Cal. 3d 633, 647-49 (1985), the California Supreme Court held: "In short, if the interest of a public officer is shown, the contract cannot be sustained by showing that it is fair, just and equitable as to the public entity." *Id*. at 649; *see also id*. at 652 (emphasis in original) ("*[C]ivil liability* under section 1090 is not affected by the presence or absence of fraud, by the official's good faith or disclosure of interest, or by his nonparticipation in voting. . . .").

Since 2014, the Fair Political Practices Commission has been authorized to bring administrative or civil actions against anyone "who violates any provision of [section 1090] or who causes any other person to violate any provision of those laws," but only upon written authorization from the district attorney in the county in which the violation occurred. Cal. Gov't Code §§ 1097.1(a), 1097.1 (b). If the FPPC proceeds in a civil action, then the maximum penalty is "the greater of ten thousand dollars ($10,000) or three times the value of the financial benefit received by the defendant for each violation." The statute of limitations for such civil actions is four years from the date the violation occurred. *Id*. § 1097.3(c).

B. What It Means To "Make" A Contract

In determining what constitutes a contract under section 1090, courts and the Attorney General have defined the term broadly to include transactions that may not traditionally be thought of as contracts. *See*, *e.g.*, *Honig*, 48 Cal. App. 4th 289 (1996) (applying section 1090 to grants); 89 Op. Cal. Atty. Gen. 258 (2006) (applying section 1090 to a city council's contribution to a nonprofit); 85 Op. Cal. Atty. Gen. 176 (2002) (applying section 1090 to city council's grant of public funds to a nonprofit); 78 Op. Cal. Atty. Gen. 230 (1995) (applying section 1090 to a city's development agreement); 75 Op. Cal. Atty. Gen. 20 (1992) (applying section 1090 to prohibit a hospital district from paying the travel expenses of a board member's spouse).

Although section 1090 does not define what it means to "make" a contract, the courts and the Attorney General have likewise broadly construed the term to apply to participation at any stage of the contracting process. Participation in making a contract includes "any act involving preliminary discussions, negotiations, compromises, reasoning, planning, drawing of plans and specifications, and solicitation for bids." *Healy* Adv. Ltr., FPPC No. A-17-159 (Aug. 16, 2017).

The California Supreme Court established this point in the seminal case of *Stigall v. City of Taft*, 58 Cal. 2d 565, 569 (1962), where a city council member participated in developing a request for proposals and, after resigning from the council, assisted his plumbing company in submitting the low bid for its completion. Although the council member was no longer a public official and had no role in approving the final contract, the Court nonetheless found that he had "made" the contract by virtue of his earlier participation in the development of the RFP. *Id.* at 568-69. The Court declined to adhere to a technical reading of what it means to "make" a contract, and instead construed the term broadly in light of the statutory objective to "limit the possibility of any personal influence, either directly or indirectly which might bear on an official's decision." *Id.* at 569. It was in this context that the Court concluded the term "made" encompassed the planning, preliminary discussions, and drawing of plans and specifications. *Id*. at 571. Because the council member had a financial interest in the contract he "made," he was found to have violated section 1090.

The courts have also found violations of section 1090 where the official attempted to influence a contracting decision, even if he did not have a formal role in the making of the contract, "if it is established that he had the opportunity to, and did, influence execution directly or indirectly to promote his personal interests." *People v. Sobel*, 40 Cal. App. 3d 1046, 1052 (1974) (citation omitted); *see also People v. Wong*, 186 Cal. App. 4th 1433, 1450-51 (2010) (municipal airport commissioner who received payment to influence harbor commission's decision to negotiate with a third party violated section 1090).

Thus, in order to avoid "making" a contract within the meaning of section 1090, public officials cannot participate in the awarding of the contract in any way, including an attempt to influence the award.

C. What Constitutes A Financial Interest?

The concept of financial interest is defined broadly. "Although Section 1090 does not specifically define the term 'financial interest,' case law and Attorney General opinions state that prohibited financial interests may be indirect as well as direct, and may involve financial losses, or the possibility of losses, as well as the prospect of pecuniary gain." *Hensely* Advice Letter, FPPC No. A-16-254 (2017). "However devious and winding the chain may be which connects the officer with the forbidden contract, if it can be followed and the connection made, the contract is void." *People v. Deysher*, 2 Cal. 2d 141, 146 (1934) (citation omitted).

In *Honig*, 48 Cal. App. 4th at 320, the Court stated, "we cannot focus upon an isolated 'contract' and ignore the transaction as a whole," and so "[t]he use of a third party as a contractual conduit does not avoid the inherent conflict of interest in such a transaction." *Id.* "[F]orbidden interests extend to expectations of benefit by express or implied agreement and may be inferred from the circumstances." *Id.* at 315. That the interest "'might be small or indirect is immaterial so long as it is such as deprives the [people] of his overriding fidelity to [them] and places him in the compromising situation where, in the exercise of his official judgment or discretion, he may be influenced by personal considerations rather than the public

good.'" *Lexin v. Superior Ct*., 47 Cal. 4th 1050, 1075 (2010) (quoting *Terry v. Bender*, 143 Cal. App. 2d 198, 208 (1956)). Thus, "[t]he law does not require that a public officer acquire a transferable interest in the forbidden contract before he may be amenable to the inhibition of the statute, nor does it require that the officer share directly in the profits to be realized from a contract in order to have a prohibited interest in it." *Honig*, 48 Cal. App. 4th at 315 (citations omitted). "Put in ordinary . . . terms, an official has a financial interest in a contract *if he might profit from it*." *Id*. at 333 (emphasis added).

Although the vast majority of cases and Attorney General opinions involve the prospect of financial gain, the courts and the Attorney General have also referred to the potential for a loss as a "financial interest" for purposes of section 1090. Even in those cases in which there is a potential loss, however, the analysis turns, at least in part, on the prospect of financial gain. Thus, in *People v. Watson*, 15 Cal. App. 3d 28, 45 (1971), a commissioner on the Los Angeles Board of Harbor Commissioners was convicted at trial of violating section 1090, and appealed to challenge the sufficiency of the evidence and jury instructions. The court affirmed, finding that the evidence supported the verdict, because it demonstrated that the Commissioner had loaned money to a man for a business venture that eventually involved a lease agreement that was approved by the Harbor Commission with the Commissioner's vote. The court found that Commissioner had a financial interest in the lease because it *enhanced* the security of the loan. *Id.* at 37. The court also affirmed jury instructions that referred only to the "contingent possibility of monetary or proprietary benefits." *Id.* at 37-38.

The same is true of an opinion in which the Attorney General advised a city council that it was prohibited from approving a pro bono legal contract with a law firm that employed a council member, because the contract could have a financial effect on the firm even though the firm agreed to provide the services for free. 86 Op. Cal. Atty. Gen. 138 (2003). Although the Attorney General cited the firm's interest in avoiding expenses as an example of a financial interest, the Attorney General also cited the potential for the firm to obtain additional business as a result of the prestige it would enjoy due to its work for the city.

In a more recent decision, however, the Court of Appeal concluded that the CEO of a hospital district, George Bischalaney, who also served as the President and CEO of a nonprofit established by the district and Sutter Health to manage the hospital, did not have a financial interest under section 1090 in a contract made between the district and the nonprofit because there was no nexus, direct or indirect, between the contract and the compensation Bischalaney received from his nonprofit employer. *Eden Township Healthcare District v. Sutter Health*, 202 Cal. App. 4th 208, 222 (2011). Although Bischalaney was the CEO of both the hospital district and the nonprofit, he participated in the negotiation of the contract *only* on behalf of the nonprofit. He did not attempt to influence the hospital district's board of directors to enter into the agreement with the nonprofit. *Id.* at 215. The court acknowledged that Bischalaney had a financial interest in the salary he received from his employer, but it concluded that the District had not shown that the contract had a nexus to his salary. *Id*. at 222. The court distinguished such decisions as *Thomson* and *Honig* and the Attorney General opinion involving a contract for *pro bono* legal services, discussed above, on the ground that in

each of those instances, "the party who was found to have had a prohibited financial interest received a *tangible benefit* that arose out of the contract at issue." *Id*. at 226 (emphasis added). By contrast, in the case before it, the court concluded that "[t]here is simply no evidence of any change in [the chief executive officer's] salary, benefits, or status in this record" and therefore "there is no disqualifying conflict of interest." *Id*. at 227.[2]

However, the *Eden Township* court made clear that when there is *any* nexus between the contract and a prohibited financial interest, even an indirect one, the connection is sufficient to trigger the application of the statute. The court distinguished *Honig* on the basis that "a pathway exist[ed] that would trace . . . financial benefit" from the contracts between the Department of Education and the school districts to the state superintendent himself. *Eden Township,* 202 Cal. App. 4th at 224. Specifically, the money flowing to the school districts was used to pay educators working for the superintendent's wife's nonprofit, which then freed up resources that the nonprofit used to pay the wife's salary. *Id.*

II. CONSULTANTS ARE SUBJECT TO 1090

A. Consultants May Face Civil And Criminal Liability For Violating 1090

Many courts, the Attorney General, and the FPPC have said that section 1090 is applicable *in the civil context* to consultants and independent contractors "whose official capacities carry the potential to exert considerable influence over the contracting decisions of a public agency"; such consultants "may not have personal interests in that agency's contracts." *Hub City Solid Waste Services, Inc. v. City of Compton*, 186 Cal. App. 4th 1114, 1124-25 (2010). Three appellate courts have gone so far as to hold that a corporate entity could be considered a consultant for section 1090 purposes. *California Taxpayers Action Network v. Taber Construction, Inc.,* 12 Cal. App. 5th 115, 146-47 (2017); *Davis v. Fresno Unified Sch. Dist.*, 237 Cal. App. 4th 261 (2015); *McGee v. Balfour Beatty Construction, LLC*, 247 Cal. App. 4th 235, 247-48 (2016). The FPPC similarly advises that corporate entities that contract with a public agency can be subject to section 1090. *Chadwick* Adv. Ltr., FPPC No. A-15-147 (Sep. 29, 2015).

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[2] Note that the peculiar facts of the case may have influenced the outcome. The hospital district initiated the action after a change in the composition of the board in an effort to undo the prior board's decision to sell the hospital to Sutter. The new board decided that it was not in the district's best interests to sell the hospital and sought an order declaring the contract void even though the former board's negotiating team testified that they understood that Bischalaney participated in the negotiations exclusively on behalf of the non-profit. The court noted: "The District does not claim it will be adversely affected, from a *financial* standpoint, if the [hospital] sale is completed. Indeed, as best we can discern, the District's main issue with the transaction is based on public policy concerns regarding the loss of emergency room access, and not public finances. This policy concern, standing alone, is not a proper basis for section 1090 liability." *Id*. at 224-25.

The California Supreme Court recently confirmed that consultants can be found *criminally* liable under section 1090. *People v. Superior Court (Sahlolbei)*, 3 Cal. 5th 230, 233 (2017). The Court overruled an earlier court of appeal decision that held independent contractors could never be held criminally liable under section 1090. *Id.* at 247. *People v. Christiansen*, 216 Cal. App. 4th 1181 (2013) (overruled by *Sahlolbei*, 3 Cal. 5th at 247).

The Court offered guidance with respect to which consultants are subject to section 1090. The Court held that section 1090 applies to consultants and independent contractors who "have duties to engage in or advise on public contracting that they are expected to carry out on the government's behalf." *Sahlolbei, 3 Cal. 5th at* 245. In that instance, the defendant's duties as a member of the hospital's medical executive committee brought him within the scope of the statute, including section 1090's criminal liability provisions, even though he was an independent contractor, because he influenced the hospital to hire another doctor and profited from that doctor's contract. Under this decision, Government Code section 1090 applies to independent contractors who serve as trusted advisors to government agencies. *Id.* at 240. Thus, section 1090 applies to consultants that advise government agencies with respect to third party contracts. However, the Court in dicta indicated that the ordinary rules of section 1090 "might give way in circumstances where a contractor reasonably believed he or she was not expected to subordinate his or her financial interests to the public's." For example, the Court wrote, "a stationery supplier that sells paper to a public entity would ordinarily not be liable under section 1090 if it advised the entity to buy pens from its subsidiary because there is no sense in which the supplier, in advising on the purchase of pens, was transacting on behalf of the government." *Id.*

B. Consultants May Negotiate The Terms Of Their Own Contract

The courts, the FPPC, and the Attorney General have recognized that consultants must be able to negotiate their own contracts with the public entity, including a provision to be paid additional compensation for services beyond their regular duties, so long as they are operating solely in their private capacity when doing so. *Campagna v. City of Sanger*, 42 Cal. App. 4th 533, 539-40 (1996); *McEwen* Adv. Ltr., FPPC No. I-92-481 (1993); *see also Pansky* Adv. Ltr., FPPC No. I-14-096 (2014) (advising that there is no 1090 violation where contract with lawyer includes a provision under which the agency will pay the counsel or his or her law firm additional compensation to litigate matters on which he or she advises the agency). However, as the Attorney General recently opined (*see* discussion in section IIC, below), that additional compensation cannot be contingent on the execution of contracts with third parties. Furthermore, this exception does not create an opening for a consultant to use his official position to influence a decision that leads to a *new* contract with his employer or that otherwise results in a financial benefit to the contractor outside the scope of the existing contract.

In *Campagna*, for example, a contract city attorney entered into an agreement with the city to provide ongoing advice and representation for a set monthly retainer and litigation services "on a reasonable legal fee basis." 42 Cal. App. 4th at 535. Acting on the

attorney's advice, the city agreed to institute litigation against a chemical company and to retain his firm for that litigation on a contingency fee basis. The city subsequently approved a contract with the contract city attorney's firm and a second firm to handle the litigation. *Id.* at 536. The Court of Appeal found that the contract city attorney could negotiate the terms of his firm's compensation for the litigation services because his existing contract contemplated that he would provide such services for a reasonable fee. *Id.* at 540. However, the Court also concluded that he violated section 1090 by negotiating in his capacity as city attorney a referral fee that he received in his personal capacity from the second law firm. *Id*. at 541-42. In other words, because he used his official position to influence a contract in which he had a financial interest, the court found he had violated section 1090.

Similarly, in *HUB City Solid Waste Servs., Inc. v. City of Compton*, 186 Cal. App. 4th 1114 (2010), the Court of Appeal concluded that a contractor who managed the city's in-house waste management division had violated section 1090 by participating in the city's decision to outsource the city's waste disposal operations to a newly created company in which the contractor was the sole shareholder. Pursuant to his original contract with the city, the contractor acted as the director of the in-house waste division, "working alongside city employees, overseeing day-to-day operations of Compton's waste management division, and taking responsibility for public education and compliance with state mandated recycling and waste reduction efforts." *Id.* at 1120. While serving in that capacity, he proposed to take over responsibility for waste disposal by licensing the city's trucks and facilities and hiring its employees. The city then entered into a no-bid contract with the newly created company to take over the city's waste disposal operations. The Court summarized its conclusion as follows:

> Pursuant to the management agreement . . ., [the contractor] supervised city staff, negotiated contracts, and purchased equipment and real estate on behalf of the city. His activities served a public function, and he was intricately involved in the city's waste management decisions. As [the sole shareholder of the new entity], [the contractor] had a personal financial stake in the franchise agreement. That interest was neither remote nor speculative, and resulted in an immediate and obvious conflict of interest. It cast doubt on whether [the contractor] was acting in Compton's best interest when he proposed franchising the city's waste management services and licensing city-owned equipment and facilities.
>
> *Id*. at 1125.

The Court rejected the contractor's argument that he was acting in his personal capacity when he proposed the arrangement to the city, noting that the "'negotiations, discussions, reasoning, planning and give and take' leading to the execution of a contract are deemed to be part of the making of an agreement under section 1090." *Id.* at 1126 (internal quotations omitted).

Recent appellate decisions involving school construction contracts have also found that a consultant who helps a government agency design a project may not enter into a subsequent contract to carry out the same project. Last year, the First District Court of Appeal held that taxpayers stated a cause of action under section 1090 by alleging that a corporate consultant to a school district, who had provided "preconstruction services" related to a building project, could not then contract with the district to complete the construction project under a lease-leaseback arrangement. *California Taxpayers Action Network v. Taber Constr., Inc.*, 12 Cal. App. 5th 115, 147 (2017). The Second District Court of Appeal reached the same conclusion in *McGee v. Balfour Beatty Constr., LLC*, 247 Cal. App. 4th 235, 249 (2016). In that case, the plaintiff alleged that the construction firm provided preconstruction services to a school district, including budgeting and development of plans and specifications, which rendered invalid a subsequent lease-lease-back construction contract.

C. A Consultant May Not Advise An Agency Regarding A Third Party Contract In Which The Consultant Has An Interest

These cases illustrate that a consultant may negotiate, in the consultant's individual capacity, to provide additional services contemplated by the original contract, but may not advise the government agency with respect to a contract with a third party in which the consultant has an interest.

A 2016 opinion of the Attorney General and a 2014 opinion of the FPPC interpreting section 1090 illustrate the distinction between the two scenarios. In 2016, the Attorney General considered an arrangement under which a contract city attorney's agreement for services provided that the contract attorney would also act as the city's bond counsel and would be paid a percentage of the bond issuance as compensation, if the city were to issue bonds during the contract period. 99 Op. Cal. Atty. Gen. 35 (2016). The Attorney General concluded that each such bond issuance is a public contract, and that the contract city attorney is precluded from being financially interested in those contracts, even if such an arrangement is specified in advance of any bond issuance in her agreement with the city. The contract city attorney would be involved in "making" the contract by advising the city on decisions regarding the size and scope of the bond issuance. She would be financially interested in the contract because she would only get paid if the bonds were issued and her compensation would vary depending on the size of the issuance. Although the Attorney General found the contingent nature of the payment troubling because it created the potential for a conflict between the contract attorney's personal and public interests, the opinion stressed that "it is the fact that the city attorney has a financial interest in the bond *contract*, rather than the contingent nature of the compensation, that presents a problem under section 1090."[3] *Id.*, n.28 (emphasis in original).

[3] Before issuing the opinion, the Attorney General sought and received comments from many law firms providing contract city attorney services, all of which, not surprisingly, argued against

(continued . . .)

The opinion in that sense draws on *Campagna*, 42 Cal. App. 4th 533, in which the court found that the city attorney did not violate section 1090 when he negotiated a contract between his own firm and the city to provide additional litigation services on a contingent basis, but did violate the statute when, acting in his capacity as city attorney, he negotiated a second contract for litigation services to be provided by his own firm and a different firm on a contingency basis, for which the other firm agreed to pay him a referral fee. The court distinguished the two situations on the basis that the second contract was not between the city and Campagna directly, but rather with a third party. The Attorney General concluded that in both *Campagna* and the facts before it, "the section 1090 violation stems not from the contingent nature of the fee, but from the financial interest in a contract made on behalf of the city." 99 Ops. Cal. Atty. Gen. 35, n.28. *See also People v. Gnass*, 101 Cal. App. 4th 1271 (2002) (city attorney violated section 1090 by serving as disclosure counsel for 10 bond contracts issued by various joint powers authorities that he had participated in making in his capacity as city attorney).

Other parts of the Attorney General opinion, however, suggest that the percentage compensation was indeed a big factor in finding a conflict. The opinion states:

> The incentive created by this compensation structure – in which the contract city attorney would be paid for his or her bond work only if the city issues bonds and would be paid more the larger the bond issuance – puts the attorney in the compromising situation where, in the exercise of his official judgment or discretion, he may be influenced by personal considerations rather than the public good. The city attorney, who must provide the city with unbiased advice, instead has a personal interest which might interfere with the unbiased discharge of his duty to the public or prevent the exercise of absolute loyalty and undivided allegiance to the best interests of the governmental unit which he represents. Section 1090 forbids the creation of a

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(. . . continued)
finding a section 1090 violation so long as the initial contract expressly contemplated the additional services and compensation. The FPPC's comment letter, while lacking any lengthy analysis, agreed with the city attorneys. To date, the Attorney General's opinion has not been cited yet by any court opinion. The FPPC has cited it once, but only for the proposition that section 1090 does not apply to the making of the original contract and that a consultant may negotiate in his private capacity to amend the contract to perform additional services. *Calabrese* Advice Letter, FPPC No. A-17-087.

> situation whereby [the official] becomes interested in a public contract.
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> 99 Ops. Cal. Atty. Gen. 35 (footnotes and internal quotation marks omitted).

By contrast, in the *Pansky* Advice Letter, No. I-14-096 (2014), the question before the FPPC was whether there was a violation of section 1090 when an outside construction counsel's contract with a government agency included a provision under which the agency would pay the counsel or the counsel's law firm additional compensation to litigate matters on which the outside counsel advises the agency. The FPPC concluded that the initial contract did not pose a problem under section 1090 because the attorney was acting in his private capacity, but proceeded to analyze whether the attorney's participation in subsequent decisions on whether he should receive additional compensation pursuant to the original contract constituted a section 1090 violation.

The FPPC found that the attorney's participation in these matters did not violate the statute. It contrasted the construction counsel's scenario with that in 66 Op. Cal. Atty. Gen. 376 (1983), which involved a redevelopment agency counsel whose compensation was based on a percentage of the increase in the assessed value of parcels of property in the redevelopment area. The redevelopment agency counsel would be involved in an advisory capacity to the city in the discussion, negotiation, and drafting of a wide variety of public contracts that could increase the value of parcels in the redevelopment area. *Id.*

Noting that there was significant difference between the facts of the two situations, the FPPC wrote:

> In the Attorney General's opinion, the contracting decisions in which the attorneys participated involved redevelopment contracts with outside entities made after the attorneys' compensation arrangement was established by the city. The construction counsel contract we address here only involves the original compensation arrangement made by the construction counsel with the city and any additional compensation does not involve a future separate contract with an outside party in which the construction counsel has a financial interest. Thus, there appears to be a significant difference between these matters in that the construction counsel's additional compensation is not the subject of a later contract.
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> *Id.*

Thus, authorities that have considered this question have found that it is not a violation of section 1090 for a public official to receive additional compensation for services

contemplated by the original contract, but that advising an agency with respect to a third party contract in which the consultant has an interest violates section 1090.

D. Consultants Who Advise Agency About A Project Cannot Obtain Subsequent Contract To Carry Out New Phase Of Project

Recent advice letters issued by the FPPC illustrate that a consultant who advises an agency regarding a project may not subsequently contract with the agency to carry out an additional phase of the project, with three narrow exceptions: (1) where the consultant provides only technical advice; (2) where the new contract results from a de novo review; and (3) where the consultant has neither the possibility of gain nor loss as a result of the subsequent contract decision.

Under section 1090, an independent contractor or consultant is generally prohibited from entering into a subsequent contract to complete a project if the consultant had extensive involvement in the initial design and development of the project. *Simon* Adv. Ltr., FPPC No. A-17-148 (citing *Hub City*, 186 Cal. App. 4th at 1125). In those situations, the FPPC has advised that the consultant has exerted considerable influence on the contracting decision of the public agency because of its initial involvement in setting the parameters for the subsequent work and therefore is prohibited under section 1090 from participating in the subsequent phase. *Ciccozzi* Adv. Ltr., FPPC No. A-17-049 (2017); *see also Fowler* Adv. Ltr., FPPC No. A-15-228 (corporate consulting firm that, under initial contract with the City of Santa Rosa, assisted City Council in understanding current development impact fees and evaluated those fees in preparation for City's upcoming update of those fees, could not enter into subsequent contract with City to update those fees because it had been "intricately involved in developing and forming" the RFP that would lead to that subsequent contract).

There are, however, three exceptions to that general rule. First, the FPPC has opined that if the consultant played a limited technical role in the initial design phase and was "removed from directly advising City staff" with respect to the scope of work for the subsequent phase, then section 1090 would not apply because the consultant could not be considered an "employee" of the agency. *Chadwick* Adv. Ltr., FPPC No. A-15-147 (2015). In *Chadwick*, the City of San Diego contracted with Schmidt Design Group (SDG) to provide the general development plan for the redesign, and SDG in turn hired several subcontractors to provide technical advice on matters such as irrigation, civil engineering, and geotechnical matters. After the general development plan was approved, the City issued an RFP to implement the plan, based on SDG's plans and research. While the FPPC determined that SDG was prohibited under section 1090 from responding to the RFP, it concluded that several subcontractors that worked on the initial design phase were not. The FPPC reasoned that the subcontractors that merely provided technical input, submitted reports directly to SDG, and did not directly advise City staff and did not exert sufficient influence over the design phase to foreclose their ability to work on the subsequent implementation phase.

Second, a consultant that works on an initial phase of a project may be able to work on a subsequent phase if the subsequent work requires *de novo* and more detailed analysis than what the consultant provided initially, and the consultant did not advise the public agency on the scope of work to be performed on the second contract. In the *Grossman* Advice Letter, FPPC No. A-17-167(a) (2018), the FPPC advised that HSE, an engineering firm, could provide the City of Belmont design plans, construction and engineering support for the rehabilitation of a sewer pump station, notwithstanding the fact that HSE had previously undertaken an assessment of the pump station, which included recommendations and a cost analysis for improvements. The FPPC advised that despite its earlier work, HSE did not exert considerable influence over the City's decision to enter into the second contract for engineering design and implementation work for improving the pump station, because HSE (1) did not engage in or advise the City with respect to the scope of the second contract, and (2) HSE's initial work was an assessment and inventory report, and did not set design criteria or recommendations for the second contract that "could give HSE an advantage in providing engineering services" under the second contract. The FPPC went on to state that that the work HSE performed under the first contract was distinctly different "in scope, detail, and purpose" from work required under the second contract, and the scope of work for the second contract "requires the successful respondent to make a *de novo* evaluation of the Pump Station rehabilitation." Given these specific facts, the FPPC concluded that HSE was not prohibited under section 1090 from bidding on the work.

Third, in 2015, the FPPC advised the City of Hawthorne that its contract with Good Energy, an energy consulting company, to assist the city in establishing and managing a community choice aggregation program did not violate section 1090 because Good Energy did not have a financial interest in the city's contracts with energy suppliers, even though the city paid Good Energy a per-kilowatt-hour fee for electricity purchased for the program. *Ennis* Adv. Ltr., FPPC No. A-15-006 (2015). The contract required Good Energy to provide "Program Design Services," which involved preparing a feasibility study and implementation plan, and "Program Management Services," which included preparing bid packages for, and negotiating contracts with, energy suppliers. The contract provided that the city would pay a flat fee of $100,000 for Program Design Services, and that for its Program Management Services, Good Energy would be entitled to a fixed rate fee of "$.001/kilowatt-hour to be paid for by the elected electricity supplier per kWh (volumetrically) for electricity purchased for the duration of the municipal contract."

The FPPC concluded that Good Energy was subject to section 1090 because its employees acted as the city's experts and influenced the city's contract decisions, and because its employees participated in decisions involving contracts. However, section 1090 did not prevent the city from executing the contract with Good Energy because Good Energy did not have a financial interest in the city's contracts with energy suppliers. The FPPC reasoned that the contract fixed Good Energy's compensation at the outset and that "[n]o matter the contract for energy supplier obtained, Good Energy's compensation will remain at that rate." Thus, "Good Energy has neither the possibility of financial loss or gain."

III. POTENTIAL CONFLICTS ARISING FROM HOLDING TWO POSITIONS

While most case law and advice regarding section 1090 involves a contract between a government agency and a private entity, it is important to recall that section 1090 applies to contracts between government agencies as well.

Indeed, Monterey County succeeded in having a contract with a water district declared void because a member of the board of the County's regional water agency was also being paid as a sub-consultant to the water district. In *California-American Water Co.*, 2 Cal. App. 5th 748, 765-66 (2015), the Court invalidated three contracts made by the county water agency while one of its board members was under contract with a private firm as a subcontractor to a water district with which the county water agency was negotiating to build a desalination project. *Id.* at 752. To address Monterey County's water needs, the county water agency, a water district, and a water company entered into five interrelated agreements to collaborate on a water desalination project. After it was revealed that a member of the board of the county's water agency had received income as a subcontractor to the water district, the county took the position that the agreements were void under section 1090. The Court agreed, and held that the contracts were void under section 1090, derailing a project that was years in the making. The water agency board member was ultimately convicted of a felony for violating section 1090. *Id*. at 753.

While this may be an extreme example, it is relatively common for an employee of one public agency (e.g., a city attorney) to serve on the board of another agency (e.g., a school district). In recognition of this fact, the Legislature has adopted exceptions to govern such circumstances. Ordinarily, when an official has a financial interest for purposes of section 1090, neither the official nor any body or board of which he or she is a member may participate in "making" the contract. However, Government Code section 1091 sets out certain "remote interests" that allow the board to act as long as the conflicted member discloses his or her interest to the board, the interest is noted in the board's official records, and the board approves the contract without counting the vote of the member with the remote interest. Cal. Gov't Code § 1091(a).

One such remote interest is "[t]hat of a person receiving salary, per diem, or reimbursement for expenses from a government entity." Cal. Gov't Code § 1091(b)(13). Whenever a member of a government body or board receives salary from a department of another public agency that would be affected by a decision of the board on which the member sits, the board may enter into the contract with the member's agency/employer, provided that the interested member complies with the requirements of section 1091(a).

Government Code section 1091.5 sets forth additional exceptions for non-interests. When an officer's financial interest is deemed a non-interest, the officer may participate in the decision without violating the statute. One such non-interest is:

> that of a person receiving salary, per diem, or reimbursement for expenses from a government entity, unless the contract directly involves the department of the government entity that employs the officer or employee, provided that the interest is disclosed to the body or board at the time of consideration of the contract, and provided further that the interest is noted in its official record.
>
> Cal. Gov't Code § 1091.5(a)(9).

Taken together, the remote interest exception in section 1091(b)(13) and the non-interest exception in section 1091.5(a)(9) mean that whenever a contract would affect the *department* of a government entity that employs a board member, the board may only approve the contract if the interested member recuses himself or herself and the board approves the decision without counting that member's vote. However, if the contract would affect a department other than the department that employs the board member, the board member may participate in the vote, provided that he or she discloses the interest and the interest is noted in the agency's official records.

When an official holds a leadership position with an agency that contracts with the Board on which he or she sits, a contract with any department of the agency would likely "directly involve[ ] the department of the governmental entity that employs the officer or employee . . . ." *See Jackson* Adv. Ltr., FPPC No. A-15-223 (Dec. 23, 2015).

In *Lexin*, the California Supreme Court concluded that this exception "was intended to apply to situations where the body or board of which an official is a member is contemplating a contract with-or on behalf of-a government entity for which the official also works." 47 Cal. 4th at 1079. The Court explained:

> The exception to the exception, for contracts that "directly involve[ ]" the official's or employee's own department, limits this provision slightly. We infer that while the subdivision was intended to excuse an existing government employment relationship as itself insufficient to give rise to a conflict, where a particular contract involved the official's own department, the risk that it might have personal impacts, generating additional income or other benefits for the employed official, was in the Legislature's eyes too great a risk to permit. Thus, while section 1091.5(a)(9) excludes from section 1090 an existing interest in government salary, it does not permit contracts – those with or directly involving one's own department – that pose a risk of potentially changing the official's salary or other employment

> financial interests. Prophylactically, contracts directly affecting the official's department are excluded.
>
> *Id*. at 1079-80.

The Attorney General's conflict of interest guide also addresses this point. "When the official in question is a member of the governing board, and not a member of a 'department' of the agency, the official would have a non-interest in the contract between the two agencies. For example, a member of a county board of supervisors who also serves as a member of a children and families commission has a non-interest in contracts between the two agencies because the 'department' limitation does not apply." California Attorney General's Office, Conflicts of Interest (September 30, 2010) Contracts between Government Agencies, p. 75.

IV. PRACTICE TIPS

A. Enter Into A Single Contract That Covers The Entire Project

As described in section II(D), the FPPC takes the position that a consultant who advises an agency regarding a project may not subsequently contract with the agency to carry out an additional phase of the project, with three narrow exceptions. Because the 1090 problem arises from entering into the subsequent contract, public agencies may be able to avoid the conflict by entering into a single contract at the outset of a project, which embraces not only any planning, consulting or other initial steps, but also the project that would be the subject of the subsequent contract. For example, if a city intends to build a bridge, rather than entering into a contract with an engineering firm for the sole purpose of providing consulting services concerning the design and placement of the bridge, the city could enter into the contract with the engineering firm to provide both consulting services for the planning phase of the project, as well as consulting services for the construction phase of the project.

B. Do Not Tie Compensation To Third Party Contracts

As described in section II(C), a conflict arises when a consultant advises a government agency with respect to a contract with a third party in which the consultant has an interest.

To minimize risks related to this problem, consider when entering into a contract with a consultant whether you may want the consultant to provide advice or in any way be involved with making third party contracts. If so, ensure that the consultant's compensation is in no way tied to any such potential third party contract.

C. Vet Contracts Between Government Agencies

Because conflicts can arise under contracts between government agencies, as discussed in section III above, it is important at the contract formation stage to analyze such contracts for potential conflicts and to take such preventative steps as are possible. Scrutinize the agencies involved to determine whether any employee of one agency also serves on the board of another agency. If the contract involves a governmental body or board with a member who draws a salary, a per diem, or receives reimbursement from another agency that would be party to the contract, consider the fact that that member would have to disclose her interest to the board, the interest would have to be noted in the official record, and a vote to approve the contract would have to proceed without the conflicted member. However, if the contract would involve a department of that member's agency other than the department that employs the member, the member would still have to provide disclosure and the agency would still have to note the interest in the official record, but could participate in the vote.

D. Hire An Independent Consultant To Negotiate Consultants' Contracts

As discussed in section II(B), the law recognizes that consultants must be able to negotiate their own contracts with the public entity so long as they are acting solely in their personal capacity when doing so. Given that it can sometimes be difficult to determine when an individual is acting in his personal capacity, rather than his official capacity, the Attorney General advises that contractors retain an individual who does not provide services to the agency to negotiate the terms of a contract with the consultant or any amendment to that contract. *See* Cal. Office of the Atty. Gen, at 66.

E. Considerations After Identifying A 1090 Problem In An Executed Contract

If you identify a potential 1090 problem in a contract that has already been executed, there are several issues to consider.

First, determine whether it is in the public entity's best interests to continue with the contract. If not, the public entity has the option under the law to void the contract, which may require the contractor with the conflict to disgorge any financial gain obtained under the contract.

If, however, it is in the public entity's best interest to continue with the contract, consider whether it is possible to ratify the contract. In an unpublished decision, *City of San Diego v. Furgatch*, the Fourth District Court of Appeal held that post-contract ratification was sufficient to cure a violation of 1090. 2002 Cal. App. Unpub. Lexis 6573, *4 (July 17, 2002). In *Furgatch*, a city council member's receipt of gifts from a contracting party on a major development project and an individual associated the project infected public contracts with a 1090 violation. After the conflicted city council member resigned, the city council reconsidered the original project, ratified the development agreement, and filed a validation action seeking a judicial declaration that the underlying contracts were valid and not subject to further

challenge under 1090 and 1092. The court of appeal held that the removal of the conflicted member and subsequent ratification by the council had the effect of curing the 1090 violation. *Id*. at *42-43.

Whether ratification will be a viable option will turn on the facts, including whether the official with the conflict has been or can be removed, and whether as a practical matter it will be possible to recreate contract deliberations in the absence of the official with the conflict.

Second, consider the consequences that could flow if the public entity does not take steps to address the problem. This could include an enforcement action from a public entity like the FPPC or district attorney, a party to the contract, or a taxpayer, with the potential for significant civil or criminal liability, the voiding of the contract, significant attorneys' fees, and negative publicity.

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