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Calif. High Court Raises Conflict Issues For Public Entities

By **Gregory Rolen**

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At long last, you passed a bond! Your community has voted to entrust you with literally hundreds of millions of dollars to improve facilities and improve lives. You are committed to doing everything possible to fulfill and maintain that public trust. But you're a public entity, a service organization and your organization does not have the expertise or person power to undertake complex construction projects. So, in line with your commitment to the public trust, you hire a program manager.

Your program manager will act as your "fiduciary and agent" in performing services. That means, legally, they are duty bound to act with the utmost good faith for your benefit. Later you find out that your program manager has another contract for construction management services, and will be earning an additional percentage of the construction costs as compensation for a job that's very similar to the one they already have. You are told this is not unprecedented but, there was no public request for proposals process, so it is unclear who selected them. It seems like, at very least, they recommended themselves, and, at most, they selected themselves. You know that if a public employee, or elected official directed public money for their personal benefit they would run afoul of California Government Code Section 1090 conflict laws. Your program manager is an independent contractor, so the laws probably do not apply to them, and if they did you are sure that the program manager, as your fiduciary, would have informed you of any potential conflict.

You break ground on several projects, but the process is slow and most projects remain unfinished. At the same time, after doing some basic math, you realize your program/construction manager is raking in millions of dollars as a percentage of total construction costs and your bond funds are being depleted even though you are nowhere near finishing the project. The voters approve additional money, but somehow the program manager/construction manager gets their contract approved for the projects on the second bond without any RFP process. Someone should start asking some questions.

Coincidentally, you receive the message from your lawyer, one of the seemingly endless notifications on new public sector cases. On June 26, 2017, the California Supreme Court in People v. Superior Court (Sahlolbei) held that independent contractors who have been entrusted with entering into transactions on a public entity's behalf can be held criminally responsible for a conflict of interest under §1090. This sounds exactly like what your program manager did. Does this mean your program/construction manager is a crook? If they are crooks how do you get the money back? Do you turn them in? How are

you going to finish the construction projects?

Although a hypothetical scenario, these are very real questions raised by the court's holding in Sahlolbei. What of outside general counsel who direct public work to firms in which they have or had either a direct or indirect financial interest? What about public employees with contracting or purchasing power, later hired to perform the same duties as an outside independent contractor? To answer these and other questions, we must examine the Sahlolbei holding, and how the court arrived there. In so doing, we will likely reach the humbling conclusion that we should have seen it coming and been better prepared.

Hossein Sahlolbei — The Face of Conflict

Hossain Sahlolbei was a surgeon in a public hospital. He was not a hospital employee, but performed surgery and served on the hospital's executive committee as an independent contractor. As an executive committee member he exercised influence over hospital policy by advising that hospital's board of governors on operations, including hiring. Sahlolbei negotiated a contract with an anesthesiologist whereby the anesthesiologist would receive $36,000 per month salary and a $10,000 relocation fee. Sahlolbei then pressured the board by threatening to direct the staff to stop admitting patients unless they hired the anesthesiologist for $48,000 per month, a $40,000 relocation fee and a $3,000 directorship bonus. Sahlolbei directed the anesthesiologist to deposit his hospital salary directly into Sahlolbei's account from which Sahlolbei paid the anesthesiologist the agreed-upon $36,000 per month. Much like our hypothetical program manager, an independent contractor with a fiduciary duty to the hospital, acted for his own financial benefit instead of for the hospital's benefit.

The district attorney charged him with a violation of §1090(a) which provides in relevant part: "Members of the Legislature, state, county, district, judicial district, and city 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." A willful and knowing violation of §1090 is punishable by a fine of up to $1,000 or imprisonment, and disqualification "from holding any office in the state." (Government Code §1097(a).) The trial court dismissed the §1090 account relying on People v. Christianson (2013) 216 Cal.App.4th 1181 (Christianson), which held that independent contractors cannot be held criminally liable under §1090. In the Court of Appeal, a divided panel upheld the dismissal. The Supreme Court granted review to determine whether independent contractors were subject to criminal sanctions under §1090.

People v. Christianson — The Outlier

The Supreme Court felt the trial court and appellate court's reliance on Christianson was badly misplaced. In Christianson, the defendant was initially employed as director of planning and facilities of the Beverly Hills Unified School District. The defendant advised the district to enter into contracts with the company named Johnson Controls. Simultaneously, Christianson's consulting business was advising Johnson Controls on how to obtain district contracts. As director, the defendant advised the district on a bond measure, and advised the district to retain her consulting company to perform project management on bond-funded projects.

Christianson was convicted of violating §1090. The Court of Appeal reversed reasoning that since §1090 did not define "employee" the common-law definition of employee should be applied to §1090. (See Reynolds v. Bennett (2005) 36 Cal.4th 1075 [where a statute refer[s] to employees without defining the term, courts have generally applied the common-law test of employment].) The Sahlolbei court

criticized Christianson's reliance on Reynolds as overly rigid, instead opting to rely on the history and purpose of §1090 to determine the legislative intent. All too often in the law we are accused of elevating form over substance. Here, the Supreme Court did the opposite.

The Sahlolbei Court — Substance Over Form

In 1924, Spreckels v. Graham (1924) 194 Cal. 516, 530 created a formulaic definition of "public officer" involving permanence and the delegation of sovereign governmental functions. However, in Schaefer v. Bernstein (1956) 140 Cal.App.2d. 198 the court expanded that definition concluding that an outside attorney hired by city could be liable under §1090. Schaefer held that, "statutes prohibiting personal interest of public officers in public contracts are strictly enforced," and what mattered was that the attorney was hired to advise on contracting. (Schaefer at 291.) In 1963, the Legislature revised §1090, relying on the Schaefer holding. First, the Assembly Interim Committee on Governmental Organization cited Schaefer for its view that conflict-of-interest statute should be strictly enforced. Then, in a subsection entitled, "Advisory Position" the committee repeated Schaefer's holding verbatim that, "a contract may be contrary to public policy where an official in a position to advise or influence officials making a contract has a personal interest in the contract. A person is in an advisory position to the city is affected by the conflict-of-interest rule." In light of the Legislature's reliance on Schaefer, it is clear that §1090's reference to "officers" applies to outside advisers with contracting responsibilities.

Only two years later, the California attorney general observed that Schaefer applied, "the policy, if not the letter of §1090" to outside advisers. (46 Ops. Cal. Atty. Gen. 74, 79 (1965). The attorney general opined that independent contractors who serve the public temporarily should serve the public at the same "fealty" as those who do so permanently. The Courts of Appeal have generally agreed with the attorney general.[1]

The court went on to explain its analysis in the context of other public ethics statutes. The court explained that §1090 and the Political Reform Act of 1974 (§81000, et seq.) are the most important California statutes preventing conflicts of interest by public officials and employees. "As such, the courts have stated that they will be interpreted in unison and will 'incorporate congruent principles' so as to render consistent applications of laws governing government contracts." (Lexin v. Superior Court (2010) 47 Cal.4th 1050, 1072.) Section 82048 defines a "public official" to include any "officer, employee, or consultant of a State or local government agency." Thus, to the extent the two statutes can be read consistently, independent contractors are included among, "members of the Legislature … officers or employees" under §1090.

Finally, the court justified its conclusion as giving effect to the purpose and intent of §1090. Section 1090 codified a long-standing common law rule that barred public officials from being personally and financially interested in contracts they formed in their official capacities (Lexin, at 1072). Because even the most well-meaning person's judgment can be impaired when their personal financial interest is affected by business they transact on the government's behalf, conflict-of-interest laws are directed not only at dishonor, but conduct that tempts dishonor. (United States v. Mississippi Valley Co. (1961) 364 U.S. 520, 549). Section 1090 is designed to ensure the public has the official's "absolute loyalty and undivided allegiance." (Stigall v. City of Taft (1962) 58 Cal.2d. 565, 569). Accordingly, the focus is on the substance, not the form of the challenged transaction, "disregarding the technical relationships of the parties and looking behind the veil which enshrouds their activities." (People v. Watson (1971) 15 Cal.App.3d 28, 37.) Thus, the focus is on whether one had the opportunity to influence execution of a contract to promote their personal interest, not their job title.

The Humbling Truth — The Surprise Is Unfortunately Not Surprising

So the obvious question is: Why are we surprised by this decision? In light of a virtually unbroken line of cases expanding §1090 liability to independent contractors, why do we still labor under the misconception that only government officials can commit conflicts of interest? Is it Christianson? Christianson is a relatively new decision with limited precedential value. Justice Goodwin Lui's opinion, written for a unanimous court, makes it abundantly clear that Christianson is an outlier that required judicial correction. The court unequivocally rejected the argument of Sahlolbei, and other shortsighted opportunists, who would have ascribed to the "perverse consequences" of Christianson by unequivocally excluding independent contractors from criminal responsibility for §1090 violations.

Then what is it? Since 1956, the court was on a clear trajectory to eliminate self-dealing regardless of technical title. In an era where the line between public and private is becoming increasingly blurred by the increased reliance on contractors, consultants, advisers, managers and yes, attorneys, the California Supreme Court made clear that if you exercise any influence over the public fisc, self-dealing is at your own risk. Perhaps the risk has become worth it.

Like the famous bank robber Willie Sutton explained when asked why he robbed banks, "because that's where the money is," government contracting is big business. The difference between Willie Sutton, Sahlolbei and our hypothetical program manager, is that while Willie Sutton used a Thompson submachine gun, our heroes use public influence and connections to relieve the public of their hard-earned money. Somehow, Willie Sutton's conduct is considered more criminal. It's time we re-evaluate this hypocrisy while at the same time re-evaluating all vendor and consultancy contracts in light of the Sahlolbei decision. Now more than ever, good government requires rejecting passive acceptance and business as usual. Who knows, you might also save your bond program.

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[1] See Campagna v. City of Sanger (1996) 42 Cal.App.4th 533, 541–542 (Campagna) [outside attorney was covered by §1090]; People v. Gnass (2002) 101 Cal.App.4th 1271, 1287, fn. 3, 1302, fn. 10 (Gnass) [accepting that an outside attorney could be covered by §1090, though the parties did not litigate the question]; California Housing Finance Agency v. Hanover/California Management and Accounting Center, Inc. (2007) 148 Cal.App.4th 682, 693 (California Housing) [outside attorney, though an independent contractor, was covered by §1090]; Hub City Solid Waste Services, Inc. v. City of Compton (2010) 186 Cal.App.4th 1114, 1125 (Hub City) [independent contractor who provided waste management services came within §1090]; Davis v. Fresno Unified School District (2015) 237 Cal.App.4th 261, 300 [extending §1090 to corporate consultants].
