

State of California



Fair Political Practices Commission

P.O. BOX 807 • SACRAMENTO, 95804 • • • 1100 K STREET BUILDING, SACRAMENTO, 95814

Technical Assistance • • Administration • • Executive/Legal • • Enforcement
(916) 322-5662 322-5660 322-5901 322-6441

August 10, 1984

Ronald J. Einboden
City Attorney
City of Covina
c/o Oliver, Stoeber & Laskin
1000 Sunset Boulevard
Los Angeles, CA 90012

Re: Request for Advice
Our No. A-84-100

Dear Mr. Einboden:

Questions have been raised regarding the correctness of the advice rendered by this agency in its letter to Charles S. Vose, your predecessor as Covina City Attorney, No. A-79-046. Our previous letter concluded that Covina City Councilmembers serving on the Board of Directors of the Covina Irrigating Company were not subject to conflict of interest disqualification under the Political Reform Act arising out of their service as members of the Board of Directors and their receipt of income in excess of \$250 for such service.

Upon careful reconsideration of our previous letter and based upon the analysis set forth below, we now conclude that the previous letter is in error and it is hereby rescinded and the advice therein may no longer be relied upon under the provisions of Government Code Section 83114(b).

FACTS

Factual information for our reconsideration of our previous letter has been provided by yourself and by Covina Councilmembers Low, Colver and Morgan, and includes many documents, too lengthy to detail here. The following is a summary of the material facts provided, facts which appear to not be in dispute.

1. The City of Covina ("City") has five elected city councilmembers, one of whom serves as mayor.

2. Pursuant to the authorization contained in Art. 16, Section 17 of the California Constitution, the City owns stock in the Covina Irrigating Company ("CIC").

3. The City owns 4,076 shares of the 10,000 shares outstanding of CIC stock.

4. Using cumulative voting, which is permitted by Art. III, Sec. 12 of the By-Laws of CIC, the City is able to elect 4 of the 9 directors of CIC by voting its shares at the annual shareholders meeting, held the fourth Saturday of February of each year.

5. Each February, the City Council has voted at one of its meetings to select the persons for whom it wishes to vote its stock to elect as CIC directors at the annual CIC shareholders meeting. Usually this group has contained two city councilmembers, although some years it has contained three councilmembers.

6. By vote at shareholders meetings, the shareholders set the compensation which CIC directors shall receive for each meeting attended. (CIC By-Laws, Art. IV, Sec. 12.) Currently, it is \$150 per meeting.

7. CIC is a private, for-profit corporation, organized under the laws of the State of California. The purpose for which it is formed is:

To procure, furnish, supply and distribute water to and for its stockholders only, for irrigation purposes, in proportion to the number of shares of stock held by them respectively.

This provision was amended in 1957 to delete a previous requirement that water be provided to CIC stockholders "at cost."

8. The meetings of the Board of Directors of the Covina Irrigating Company are closed to the public. Agendas for stockholders meetings are neither required nor public; consequently, the City Council cannot act, in its own deliberations, to instruct its representatives to the shareholder meetings as to how they should vote the City's 4,076 shares because the City Council does not know what issues will be voted on (such as raising fees to be paid to directors).

9. City-elected members of the CIC Board need not be city employees or officials and two of the four currently do not hold any official position with the City. City elected CIC Board members are not subject to the City's Conflict of Interest Code when serving on the CIC Board.

10. On February 18, 1977, the Covina City Attorney issued an opinion, which remains in effect, that the Ralph M. Brown Act (relating to open meetings of local government bodies) does not apply to meetings of the CIC Board of Directors when attended by three or more Covina City Councilmembers. In that opinion, the City Attorney stated, inter alia:

I am aware of no persuasive arguments that would suggest that attendance at a C.I.C. Board meeting by Council members would result in any greater involvement with service in their official capacity than attendance at a meeting of the Rotary or Lions' Club.

The City Attorney's opinion focuses on whether councilmembers serving on the CIC Board are serving "in their official capacity" and concludes that they are not. The opinion further points out: "The Covina Council can and has appointed private persons to serve on the CIC Board." This opinion was only recently furnished to Commission staff by Mr. Low and was not taken into consideration in our previous advice letter in 1979.^{1/}

11. The CIC, as a private stock corporation, has approximately 250 shareholders, most of whom are individuals holding small numbers of shares (less than 50). Currently, only nine of those shareholders (mostly entities) are customers of CIC. These customers represent 5,858 (or approximately 70%) of the 10,000 shares of outstanding CIC stock. For 1983, CIC paid dividends totaling \$180,000 on 10,000 shares for a dividend of \$18 per share, which was calculated to be a 15.8% return on common equity.^{2/} This compares with a 14.5% rate of return permitted by the PUC for companies regulated by it-the CIC is not regulated by the PUC.

^{1/} Informal consultation with the Attorney General confirms the apparent correctness of the advice contained in the City Attorney's Opinion.

^{2/} This appears to be based upon a dividend rate of about 10% plus another 6% or so in retained earnings per share.

ANALYSIS

In our 1979 advice letter, the recited facts include the following statement:

The City of Covina owns 40.3% of the stock of the Covina Irrigating Company, which is a mutual water company but which is nevertheless operated for profit....

Unfortunately, these two concepts are incompatible. The term "mutual water company" is defined in Public Utilities Code Section 2725 as meaning:

... any private corporation or association organized for the purposes of delivering water to its stockholders and members at cost, including use of works for conserving, treating and reclaiming water.

(Emphasis added.)

As has been shown, above, in 1957 CIC's Articles of Incorporation were amended to delete from its statement of purposes the "at cost" provision. Its 1983 financial statement shows a substantial after taxes profit, approximately 2/3 of which was distributed to shareholders in the form of dividends, with a 15.8% return on common equity (the dividend rate appears to be 10%). However, we are informed that CIC is not subject to regulation by the Public Utilities Commission.^{3/}

For our purposes, we conclude that, inasmuch as the CIC Articles of Incorporation do not on their face meet the statutory test established in Public Utilities Code Section 2725, we will treat CIC as a "business entity" within the

^{3/} Conversations with counsel in the legal division of the PUC indicate that unless the water is in fact provided "at cost," then the company is a "public utility" subject to PUC regulation. However, determination of that issue is a factual question which can only be resolved if a customer files a formal complaint with the PUC. We make no comment on the appropriateness of such an action or on the probable outcome.

meaning of the Political Reform Act,^{4/} (the "Act") Government Code Section 82005.

"Income" as defined in the Act includes any payment received. Section 82030(a). Clearly, the payments to the directors fall into this category. Section 82044. In our previous advice letter, we analogized this income to "government salaries" and therefore advised that it was exempt from being considered "income" pursuant to Section 82030(b)(2), because:

The Act does not contemplate a conflict of public interests ... the actions they take as Board members, however, are strongly analogous to other decisions they make as Councilmembers.

The service on the CIC Board was considered to be a part of the councilmembers public service in their official capacity as representative of the City. However, at the time we reached that conclusion, we were unaware of the City Attorney's Brown Act opinion and the fact that the CIC meetings were closed rather than public. Our admonition to the councilmembers:

... they should observe the policies of the Act when serving as Board members as well as Councilmembers....

is a hollow admonition if the meetings are closed and no one can monitor their activities as Board members. Furthermore, we have been advised that the City of Covina's Conflict of Interest Code does not encompass its representatives serving on the CIC Board.

Consequently, we hereby rescind our previous advice as contained in the letter to Charles S. Vose, No. A-79-046, dated June 11, 1979. Our advice is now as follows:

1. Payments received on or after September 1, 1984, will be "income" within the meaning of Section 82030(a). Therefore, if any public official receives in any 12 month period after September 1, \$250 or more in Directors' fees, CIC will be considered a source of income under Section 87103(c) and disqualification will be required if the other requirements of Sections 87100 and 87013 are met.

^{4/} Government Code Sections 81000-91014. All statutory references are to the Government Code unless otherwise specified.

You have asked whether the official could avoid this result by either refusing the payments or donating them to charity. The official may avoid this affect by either refusing the payments or by turning them over to the City of Covina.

2. Service by a public official as a member of the Board of Directors of CIC, a business entity, beyond February 28, 1985,^{5/} will be considered to meet the requirements of Section 87103(d) and will likewise require disqualification if the other requirements of Sections 87100 and 87103 are met. A director of a corporation has a fiduciary relationship to the corporation and its shareholders. California Corporations Code, Section 309(a).

3. Actions by the City Council as trustees for the City's shares of stock in CIC (such as deciding how the City's shares should be voted) are official city actions and are subject to the conflict of interest provisions of the Act.

Lastly, an issue has been raised regarding Mayor Colver's ownership of CIC stock. In the past, Mayor Colver has reported having an investment in CIC worth more than \$1,000. During the course of our review of this matter, he has amended his Statement of Economic Interests to reflect no reportable investment in CIC. Mr. Low's letter of June 12, 1984, at p.2, indicates that Mayor Colver may have inherited some stock "but that that did not count." "Investment," as the term is used in the Act, includes both direct and indirect investments, however acquired.^{6/} If Mayor Colver has any questions regarding what he should be reporting, he may contact us for advice.

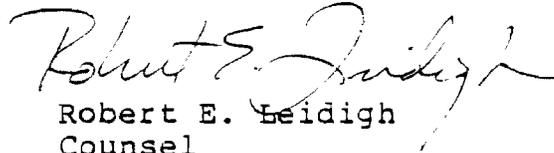
^{5/} A time period has been allowed for accomplishment of a smooth transition should councilmembers currently serving as directors wish to resign or not be reelected. Directors may be elected at the annual shareholders meeting or at a special meeting of the shareholders, which may be called for that purpose, but only if no election for directors has been held in more than one year. Since one was held this year, the next meeting would be the annual one.

^{6/} Inheritances are excluded from being considered "income" under the Act when received. However, once held, inherited stock counts as an investment if it meets the other statutory requirements. Section 82034.

Ronald J. Einboden
August 10, 1984
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In closing, I wish to emphasize that this letter in no way questions the good faith of any officials of the City of Covina in acting upon our previous advice over the past 5 years. Should you have questions regarding this letter, I may be reached at (916) 322-5901.

Sincerely,



Robert E. Leidigh
Counsel
Legal Division

REL:plh
cc: Councilmember Robert Low



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500

CITY OF COVINA

125 EAST COLLEGE STREET

COVINA, CALIFORNIA 91723

(213) 331-0111

ROBERT LOW
COUNCILMAN

May 2, 1984

Mr. Robert E. Leidigh
Legal Division
Fair Political Practices Commission
P.O. Box 807
Sacramento, Ca. 95804

Dear Mr. Leidigh:

I have re-read my letter of April 19, 1984, and I would like to expand on a few of the remarks that I made.

The Covina Irrigating Company is an unusual enterprise. Almost forty-one per cent of its stock is publicly owned by the City of Covina. Most of the remaining 59 per cent is privately controlled.

The public-private ownership creates an unusual relationship. From the City's point of view, and from the point of view of most of the people that use the water produced by the Covina Irrigating Company, there is no advantage in the company making a profit. The company pays the City dividends out of the profits the company earns, but for every dollar the company earns in profits, forty-seven per cent is paid to the State and Federal governments in income taxes.

In short, the City could double the dividend income it earns from profits if it maintained its present rate schedule while the company reduced the price it charges for its water to the point where there was no profit, and therefore no Federal or State Income Tax responsibility.

However, the City is a minor shareholder in the company, and the company is managed so as to serve the interests of the private owners rather than the publicshareholders.

The company operates like any other private company, and its goal is clearly that of making a profit. In 1983 it cost the company \$40 per acre foot to deliver water to the City, and it was marketed at the rate of \$112 per acre foot.

In 1983 the company made a 138 per cent return on sales. For 1984 the company increased its price of water another 3 per cent to \$121 per acre foot.

As indicated in the letter of April 19, 1984, three Covina City Councilmen appointed themselves to serve on the Board of Directors of the Covina Irrigating Company. The company pays each Director \$150 per meeting. The meetings are held once a month and last about one hour. They are closed to the public. The monthly fee paid the directors is raised through the sale of the company's water. In 1983, the company marketed 2,000 acre feet of water. The City of Covina purchased

600 acre feet, or sixty-nine per cent.

At the closed Board meetings the nine Directors set the price of the company's water. The company is not a regulated agency. In the same meetings the Directors establish the salaries they pay themselves.

The question is under the Political Reform Act is there any conflict of interest when a City Councilman appoints himself to serve as a Director of a public-private corporation such as that of the Covina Irrigating Company?

Respectfully yours,



Bob Jan
185 East College
Covina, Ca. 91723



F F F C
C I T Y O F C O V I N A

125 EAST COLLEGE STREET

COVINA, CALIFORNIA 91723

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ROBERT LOW
COUNCILMAN

April 19, 1984

Barbara Milman
General Counsel
Fair Political Practices Commission
P.O. Box 807
Sacramento, California 95804

Dear Ms Milman:

Following conversations with Lynn Montgomery and Bob Leidigh, it was suggested that I request from you a review of the Fair Political Practices Commission opinion of June 11, 1979, concerning the appointment of City Councilmen to the Board of Directors of the Covina Irrigating Company (attached).

A Covina City Attorney summary of the 1979 opinion has been used by the City Council as a guideline in making appointments to the Board of Directors of the Covina Irrigating Company (attached; February 11, 1983).

While the Covina Irrigating Company refers to itself as a mutual water company, its primary purpose is to make a profit by supplying water to its customers. The City of Covina buys about 70 per cent of the water the company produces. The City owns about 41 per cent of the stock of the company. The company has about 270 individual shareholders, and they own from one share to the City's 4,076 shares. There are 10,000 outstanding shares.

In 1983, on sales of \$957,128 the cost of production was \$416,460, and the net income before State and Federal Income Taxes was \$545,925. On sales that is a 131 per cent pre tax profit (page 12 - Annual Report).

The Covina Irrigating Company operates as a private company. Until last Tuesday, three Councilmen, a majority of the Covina City Council, served on the company's Board of Directors. Its meetings are closed to the public.

The 1979 FFPC opinion refers to the Covina Irrigating Company as "a mutual water company but which is nevertheless operated for profit."

#2725 of the Government Code defines a mutual water company as a private corporation or association organized for the purpose of delivering water to stockholders and members at cost...." Of the company's 270 stockholders no more than 8 make direct purchases of water from the company.

The Covina Irrigating Company has a nine member board of directors, four of which are appointed by the Covina City Council. The nine member board of directors oversees the company's three employees. The directors meet once a month for about one hour. Since the 1979 FFPC opinion the directors of the Covina Irrigating Company have increased their fees from \$50 per meeting to \$150 per meeting, a 200 per cent increase.

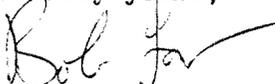
The 1979 FFPC opinion states the salaries received by Councilmen serving on the Board of Directors of the C.I.C. are "compensation for service rendered to the public, and are analogous to government salaries." It then concludes "income as used in the act specifically excludes salary and reimbursement for expenses or per diem received from state, local, or federal government agency...."

The Covina Irrigating Company acts and functions as a private company, and in 1983 it paid \$258,860 in State and Federal Income Taxes. The Board of Directors sets the salaries of its members. It pays the salaries out of company funds. The meetings where the actions are taken are closed to the public and not subject to the scrutiny of the press.

In 1984, three Councilmen on a 3 to two vote appointed themselves to serve on the Board of Directors of the CIC. Two Councilmen voted against the action in part on the grounds that it was a violation of the intent of the Brown Act. That issue appears to now be moot as one of the Councilmen was defeated in the April municipal election.

But the issue of accountability remains. Under the Fair Political Practices Act, can a City Councilman use his position as a public official to appoint himself to the board of directors of a private corporation, and then while serving in that capacity, and secluded from public scrutiny, set water rates for the community and salaries for himself and other board members that are then passed on to the public in the form of higher prices to the consumer?

Respectfully yours,



Bob Low, Councilman
125 East College Street
Covina, Ca. 91722
Home Phone: 966 8076 (Area Code 213)

Attachments:

1979 FFPC Opinion
City Attorney Opinion
CIC 1983 Annual Report
February 21, 1984 Council Minutes
CIC Appointments
Colver: Statement of Economic Interests

State of California



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August 23, 1984

Ronald J. Einboden
City Attorney
City of Covina
c/o Oliver, Stoeber & Laskin
1000 Sunset Blvd.
Los Angeles, CA 90012

Re: Our Advice Letter No. A-84-100

Dear Mr. Einboden:

This letter is written pursuant to your request for follow-up clarification to my letter to you, dated August 10, 1984. Specifically, you were concerned with the advice contained in paragraph 3 on page 6. You wanted to know whether the term "trustees for the City's shares of stock in CIC" meant that the councilmembers had financial interests in CIC (which could lead to conflicts of interest) pursuant to Government Code Section 87103(d), which contains a reference to "trustees" of a business entity. I assured you over the telephone that this was not our interpretation, but I am now confirming that advice in writing.

The term "trustee" as used in Section 87103(d) is generally synonymous with "director." Some companies refer to their officers or directors as trustees. It could also encompass a trustee in bankruptcy, although this situation is not likely to arise.

The term "trustee" as used in my letter refers to the councilmembers' status as the trustees for the city's stock. Commission regulation 2 Cal. Adm. Code Section 18234(d) states:

... a filer does not have a direct, indirect or beneficial interest in a trust by reason of being a trustee or co-trustee provided that the filer does not have a direct, indirect or beneficial interest . . . in the trust....

Ronald J. Einboden
August 23, 1984
Page 2

Consequently, the councilmembers' service as trustees for the City's stock does not, in and of itself, give them a financial interest in the Covina Irrigating Company (CIC).

Paragraph 3 in my letter was merely drawing the distinction between the private nature of the councilmembers' activities as directors of CIC and the public nature of their actions taken as the City Council relating to CIC.

Lastly, Mayor Colver has reiterated to you that he owns only one share of CIC stock and no others, inherited or otherwise. Because the fair market value of one share is less than \$1,000, he has no "investment" in CIC within the meaning of the Political Reform Act.^{1/} Consequently, no disclosure or disqualification can be required as a result of his ownership of this one share.

I trust that this letter has adequately responded to your questions. Should you have further questions, please do not hesitate to call me at (916) 322-5901.

Sincerely,


Robert E. Leidigh
Counsel
Legal Division

REL:plh
cc: Councilmember Robert Low

^{1/} Government Code Sections 81000-91014. See specifically Section 82034 defining "investment."

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July 2, 1984

Robert Low, Councilman
City of Covina
125 East College Street
Covina, CA 91723

Re: Our File No. A-84-100

Dear Mr. Low:

Unfortunately, our letters keep crossing in the mails, which underscores why it is imperative that you copy your correspondence to Mr. Einboden. Otherwise, we will be sitting here months from now with no resolution to the question at hand. This is the last time, I am sending a copy of your correspondence to Mr. Einboden along with a copy of this letter. In the future, I will disregard any communications which are not furnished by either of you "to the other side."

Lastly, I would ask that each of you make your last submissions of "material facts" (Government Code Section 83114(b)) to me, postmarked no later than July 16, with copies to each other. Any rebuttals to those must be mailed by July 20, after which I intend to complete my analysis and send out the advice letter by August first. Thank you for your cooperation.

Sincerely,

A handwritten signature in cursive script that reads "Robert E. Leidigh".

Robert E. Leidigh
Counsel
Legal Division

REL:plh
cc: Ronald J. Einboden

State of California



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June 26, 1984

Robert Low, Councilman
125 East College Street
Covina, CA 91723

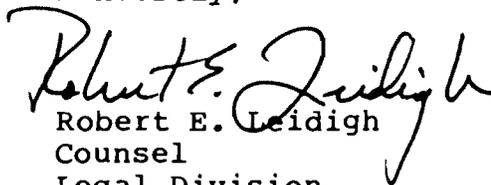
Re: Your Letter of 6/22/84
Our File No. A-84-100

Dear Mr. Low:

On June 21, 1984, I sent you copies of materials submitted by City Attorney Ronald Einboden. By copy of this letter, I am sending him copies of your June 22 communication. This agency has no jurisdiction with respect to water rates or supply amounts of Covina Irrigating Company (CIC) to the City of Covina. Nor do we have any jurisdiction with respect to the Incompatible Activities Ordinance of the City of Covina. Consequently, these matters are not relevant to our inquiry. On the other hand, I am interested in your assertion that a former Covina City Councilmember is continuing to serve on the CIC board despite his defeat at the election. By copy of this letter, I am asking Mr. Einboden to respond to this point.

Secondly, it seems foolish for this office to have to continue to copy and mail to you and Mr. Einboden each other's correspondence when, presumably, you two see each other regularly. Therefore, I must insist that all future correspondence by either of you (or Mayor Colver, etc.) indicate that it has been furnished to the other interested parties in this matter. This will greatly speed up the process. Thank you.

Sincerely,


Robert E. Leidigh
Counsel
Legal Division

REL:plh
cc: Ronald J. Einboden

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June 21, 1984

Robert Low, Councilman
125 East College Street
Covina, CA 91723

Re: Your Request for Advice
Our File No. A-84-069/00

Dear Mr. Low:

Enclosed is a copy of materials received today from Mr. Einboden in response to my letter of May 21. It is not clear to me whether copies of the letter and its attachments were furnished to you so I am forwarding copies for your comment. If possible, please respond to me by the first of July so that I may have as much input as possible prior to analyzing the questions presented.

Sincerely,

A handwritten signature in cursive script that reads "Robert E. Leidigh".

Robert E. Leidigh
Counsel
Legal Division

REL:plh
Enclosure
cc: Ronald J. Einboden

State of California



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May 21, 1984

Bob Low, Councilmember
City of Covina
125 East College
Covina, CA 91723

Re: Your Request for Advice
Our No. A-84-100

Dear Mr. Low:

Thank you for your several letters regarding the Covina Irrigating Company. We are unable to give you advice regarding the duties and obligations under the Political Reform Act of your fellow councilmembers. However, we are concerned with the continuing validity of our 1979 advice letter on the subject which is being relied upon by your city attorney and fellow councilmembers. Consequently, we have sent a letter to the Covina City Attorney, Mr. Einboden, a copy of which is enclosed. We have requested additional factual input from Mr. Einboden and your colleagues on the Council. Should you have any further information which you wish to provide to us, please do so.

Sincerely,

A handwritten signature in cursive script that reads "Robert E. Leidigh".

Robert E. Leidigh
Counsel
Legal Division

REL:plh

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May 21, 1984

Ronald J. Einboden
City Attorney
City of Covina
Oliver, Stoever & Laskin
1000 Sunset Boulevard
Los Angeles, CA 90012

Re: Advice Request by Bob Low,
Councilmember, City of Covina
Our No. A-84-100

Dear Mr. Einboden:

Pursuant to our telephone conversation on Friday, I am forwarding to you the materials and letters sent to this office by Bob Low, Councilmember, City of Covina. As I advised you by telephone, Mr. Low's letters raise questions in the minds of the Commission's staff regarding the continuing validity of our 1979 Advice Letter to Charles S. Vose (No. A-79-046), your predecessor as City Attorney, on this same subject.

However, the Commission does not render advice based solely upon facts presented by a third party. Even though Mr. Low is a Councilmember, he is still raising questions about the duties and obligations of other officials. Because our 1979 advice letter is being relied upon in this matter, we feel compelled to urge that you and the Councilmembers involved request our advice as to the letter's current validity and provide us with whatever additional material facts you deem appropriate.

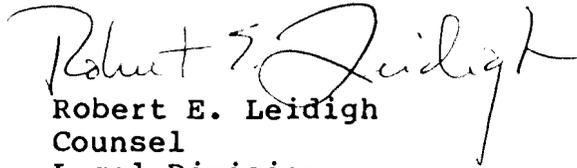
We would specifically appreciate information on the topic of why a private corporation, which holds closed meetings, should be considered "public" when it comes to income received by its board of directors? A related factual question is whether there is a Conflict of Interest Code for the Covina Irrigating Company (CIC) and/or whether the City of Covina's Conflict of Interest Code covers the City's representatives serving on the CIC Board of Directors. Also, what type of individuals have been selected

Ronald J. Einboden
May 21, 1984
Page 2

to fill the other CIC director slots elected by the City; have these been private citizens or other city officials? Finally, it would be helpful for us to know whether city councilmembers are usually paid for serving as city representatives on other governmental agencies, and, if so, whether they are paid by the city or by the agency.

Your early response will be appreciated. If I can answer any questions, I will be pleased to do so. I may be reached at (916) 322-5901. As I indicated to you on the telephone, any modification of the Commission's advice contained in the 1979 letter would operate prospectively only.

Sincerely,


Robert E. Leidigh
Counsel
Legal Division

REL:plh
cc: Bob Low, Councilmember
Enclosures