



**California
Fair Political
Practices Commission**

SUPERSEDED
by A-96-060 (Montandon)

May 22, 1989

Harry M. Marsh
MARSH, MARSH, VOLPE & MOLIN
341 Broadway, Suite 221
Post Office Box 3590
Chico, CA 95927-3590

Re: Your Request for Informal Assistance
Our File No. I-89-130

Dear Mr. Marsh:

This is in response to your letter requesting advice regarding the responsibilities of the Special District Insurance Authority under the conflict-of-interest provisions of the Political Reform Act (the "Act").¹ We do not have sufficient facts to provide a specific answer to your question. Therefore, we consider your letter to be a request for informal assistance pursuant to Regulation 18329(c) (copy enclosed).²

Our advice is limited to provisions of the Act. We cannot provide advice about other conflict-of-interest laws, such as Government Code 1090 which prohibits a public official from having a financial interest in a contract. You should consult the Attorney General about Section 1090.

QUESTION

1. Does the contemplated relationship with Arthur J. Gallagher and Gallagher-Heffernan create a conflict of interest such that the Special District Insurance Authority cannot contract for the broker and consultant services described?

¹ Government Code Sections 81000-91015. All statutory references are to the Government Code unless otherwise indicated. Commission regulations appear at 2 California Code of Regulations Section 18000, et seq. All references to regulations are to Title 2, Division 6 of the California Code of Regulations.

² Informal assistance does not provide the requestor with the immunity provided by an opinion or formal written advice. (Government Code Section 83114; 2 Cal. Code of Regs. Section 18329(c) (3).)

2. Assuming the contractual arrangements are permissible, under what circumstances should Gallagher disqualify itself from making recommendations and advice?

CONCLUSION

1 and 2. The proposed contract creates a conflict of interest. The decisions of the consultant to the district could achieve, defeat, aid or hinder the very activities for which he is paid as an employee of Gallagher. The decisions of the consultant could also materially affect Gallagher.

FACTS

Your office serves as general counsel to the Special District Insurance Authority (SDIA). SDIA is a joint powers authority created and existing as an independent public entity pursuant to Section 6500 et seq. SDIA provides various types of insurance coverage and risk pooling protections to its member districts. SDIA has adopted a standard conflict-of-interest code pursuant to Regulation 18730.

For some time, SDIA has utilized the services of Arthur J. Gallagher (a publicly traded corporation) and Gallagher-Heffernan (its wholly-owned subsidiary) (collectively "Gallagher") as its insurance broker. Gallagher has placed insurance for and provided various types of insurance advice to SDIA. In order to clarify the responsibilities of SDIA and Gallagher relative to the insurance advice aspects of the relationship, SDIA desires to enter into two separate agreements with Gallagher. You are requesting advice as to whether or not the proposed contractual relationship with Gallagher poses a potential conflict of interest problem for SDIA. The position of insurance broker is a designated position in SDIA's conflict-of-interest code. The same employee of Gallagher, a Mr. Lillis, would be providing the services under each of these agreements.

One agreement would be a contract to provide brokerage services. Gallagher would be required to search appropriate markets and to place insurance coverages as requested and directed by SDIA. Gallagher would be paid a fee and/or commission for this service as appropriate. The fee or commission would be paid by the entity receiving the placement, and is traditionally factored into the cost for the insurance. This first agreement would cover the current broker activities of Gallagher.

The second agreement would be a specific written contract wherein Gallagher, for compensation, would be required to provide SDIA with insurance and risk pooling advice. Services would include attending governing board meetings, assisting in drafting memorandum of coverages, providing advice as to risks to be

covered and excluded, evaluating existing coverage, rating risk and assisting with calculating deposits (premiums). Gallagher is currently providing many of these services voluntarily and without compensation. However, SDIA would like to enter into a specific agreement in order to establish a professional relationship and responsibility for these services.

You have indicated that, to a certain extent, Gallagher will have a financial interest in the outcome of decisions depending upon the placement of certain coverages. For example, if a decision was made to eliminate excess insurance coverage on a particular risk or to drop a certain line of coverage, Gallagher could stand to lose the commission or fee paid for the placement of the excess coverage.

ANALYSIS

The conflict-of-interest provisions of the Act prohibit a public official from making, participating in making or in any way attempting to use his or her official position to influence a governmental decision in which the public official knows or has reason to know he or she has a financial interest. (Section 87100.) This analysis will examine the proposed relationship from the perspective of the consulting contract to give insurance and risk pooling advice, since this agreement appears to be where the decision-making is intended to be placed under the proposed division of duties. The discussion would also apply to the other agreement to the extent that Mr. Lillis would be making placement decisions. This analysis is limited to an evaluation of the proposed contracts and not of the prior informal arrangement. The Commission does not give advice with respect to past conduct. (Regulation 18329(c)(4)(A), copy enclosed.)

Public Official

For purposes of the conflict-of-interest provisions of the Act, a "consultant" must meet the definition of Regulation 18700(a)(2) in order to be considered a "public official." A public official is defined, in part, as follows:

(a) "Public official at any level of state or local government" means every natural person who is a member, officer, employee or consultant of a state or local government agency.

(2) "Consultant" shall include any natural person who provides, under contract, information, advice, recommendation or counsel

to a state or local government agency, provided, however, that "consultant" shall not include a person who:

(A) Conducts research and arrives at conclusions with respect to his or her rendition of information, advice, recommendation or counsel independent of the control and direction of the agency or of any agency official, other than normal contract monitoring; and

(B) Possesses no authority with respect to any agency decision beyond the rendition of information, advice, recommendation or counsel.

(Regulation 18700, copy enclosed)

As indicated above, the consultant must be a natural person. (Russell Advice Letter, No. A-88-484, copy enclosed.) In the situation presented here, the contracts would be with Gallagher, which is not a natural person. Therefore, the analysis of any potential conflict would shift to a review of the activities of employees of Gallagher who would be involved in the consulting contract--in this case, Mr. Lillis.

Mr. Lillis, or any other member of Gallagher who would be performing duties under the proposed contracts, will be considered a consultant under the Act if he provides information, advice, recommendation or counsel to SDIA, unless: (1) he is independent of control and direction of SDIA, other than normal contract monitoring; and (2) he possesses no authority with respect to any agency decision beyond the rendition of information, advice, recommendation or counsel. (Regulation 18700(a)(2); Hayden Advice Letter, No. A-84-319, copy enclosed.)

You have indicated that Mr. Lillis' services would include attending board meetings, assisting in drafting memoranda of coverage, advising as to risks to be covered or excluded, evaluating existing coverage, rating risk and assisting with calculation of premiums. It would appear that he would be doing much more than rendering independent advice and recommendations. He would be interacting directly with decision-makers on an on-going basis. He would essentially be functioning as additional staff to SDIA. (Workman Advice Letter, No. I-87-078; Kaplan Advice Letter, No. A-82-108, copies enclosed.) Therefore, Mr. Lillis would qualify as a consultant who is a public official under the Act.

Participation in a Governmental Decision

A public official participates in the making of a governmental decision if he or she:

(1) Negotiates, without significant substantive review, with a governmental entity or private person regarding the decision; or

(2) Advises or makes recommendations to the decision-maker, either directly or without significant intervening substantive review, by:

(A) Conducting research or making any investigation which requires the exercise of judgment on the part of the official or designated employee and the purpose of which is to influence the decision; or

(B) Preparing or presenting any report, analysis or opinion, orally or in writing, which requires the exercise of judgment on the part of the official or designated employee and the purpose of which is to influence the decision.

(d) Making or participating in the making of a governmental decision shall not include:

(1) Actions of public officials which are solely ministerial, secretarial, manual or clerical....

(Regulation 18700, copy enclosed)

It seems clear from the statement of duties to be performed under the contract that Mr. Lillis would be participating in governmental decisions. He would be advising SDIA or making recommendations as to coverage either directly or without significant intervening review. His evaluations of risks to be covered or excluded would require the exercise of judgment and would not be solely ministerial or clerical.

Financial Interest

A public official may not participate in a governmental decision in which he knows or has reason to know he has a financial interest. (Section 87100.) Whether the official has a financial

interest in the decision is governed by Section 87103, which provides in part:

An official has a financial interest in a decision within the meaning of Section 87100 if it is reasonably foreseeable that the decision will have a material financial effect, distinguishable from its effect on the public generally, on the official or a member of his or her immediate family or on:

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

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

(Section 87103)

Foreseeability

The effect of a decision is reasonably foreseeable if there is a substantial likelihood that it will occur. However, there must be something more than a mere possibility that the effect will occur. (In re Thorner (1975) 1 FPPC Ops. 198, copy enclosed.)

The financial effect may be on the public official, his or her immediate family, or on a source of income to the public official. (Section 87103.) You have indicated that Mr. Lillis is an employee of Gallagher. Therefore, a conflict could occur if a decision in which he participates has a financial effect on Gallagher. Furthermore, in the event that Mr. Lillis receives any commission income in a specific transaction, the insurance company providing the policy would also be considered a source of income. (Regulation 18704.3(c), copy enclosed.)

You have already indicated that some decisions in which Mr. Lillis would participate in his capacity as insurance consultant would be likely to have a financial effect on Gallagher. For

example, if Mr. Lillis decided to eliminate excess coverage or drop a line of coverage, Gallagher would lose a commission or fee that would otherwise have been paid for the placement of the coverage. Conversely, it would be foreseeable that decisions indicating the need for increased or additional coverage would result in an increase in commissions or fees to Gallagher. In either case, the requirement of foreseeability is met.

Materiality

Even though the decisions made by Mr. Lillis would have an effect on Gallagher, no conflict of interest is created unless the effect would be material. Whether or not the effect would be material in any given case would depend upon whether the effect on Gallagher was direct or indirect, and, if indirect, the magnitude of the effect.

Regulation 18702.1 states that the effect on an official's economic interest will be deemed to be material where the interest is directly involved in a decision. With respect to sources of income, the regulation provides as follows:

(a) The effect of a decision is material if any of the following applies:

(1) Source of Income or Gifts--Any person (including a business entity) which has been a source of income (including gifts) to the official of \$250 or more in the preceding 12 months is directly involved in a decision before the official's agency or there is a nexus (as defined in subdivision (d)) between the purpose for which the official receives income and the governmental decision;

(d) There is a nexus between the purpose for which an official receives income and a governmental decision if the official receives income to achieve a goal or purpose which would be achieved, defeated, aided, or hindered by the decision.

In the contractual arrangement you are proposing, there would be a nexus between the decisions that Mr. Lillis would be making as an insurance advisor and his income as a broker. Mr. Lillis is employed as a broker to place insurance coverage for Gallagher. He receives income for this service, and he may even receive a percentage of commissions placed. As a consultant, Mr. Lillis

would be making decisions to place or not place insurance, drafting memoranda of coverage, and calculating premiums. The decisions that he would make as a consultant to SDIA could aide or hinder the brokerage work for which he is paid. Therefore, Mr. Lillis' economic interest is directly affected by the decisions he would be making, and the effect of his decisions would be deemed material. (Regulation 18702.1(a), copy enclosed.)

In addition to the direct effect described above, the decisions made by Mr. Lillis as consultant to SDIA would have an indirect effect on Gallagher. As previously indicated, a decision to purchase additional coverage or to drop a particular coverage could result in an increase or decrease in commission income payable to Gallagher. The materiality of this indirect economic effect is determined by measuring its magnitude with respect to the business entities involved. (Regulation 18702.2, copy enclosed.)

You indicated in telephone conversations that Mr. Lillis is an employee of Gallagher-Heffernan, a wholly-owned subsidiary of Arthur J. Gallagher. As a parent company, Arthur J. Gallagher will also be deemed a source of income to Mr. Lillis. (Regulation 18706, copy enclosed.) You do not know the size of Gallagher-Heffernan or whether it is publicly traded. Arthur J. Gallagher is a public corporation traded on the New York Stock Exchange. Arthur J. Gallagher is not listed as a Fortune 500 company.

Based upon the foregoing, the effect of a decision would be material as to Arthur J. Gallagher if it would result in an increase or decrease in gross revenues for a fiscal year or \$250,000 or more (Regulation 18702.2(a)(1)); it would result in the incurring, avoiding, reducing or eliminating of expenses for a fiscal year in the amount of \$100,000 or more (Regulation 18702.2(a)(2)); or it would result in the increase or decrease of assets or liabilities of \$250,000 or more (Regulation 18702.2(a)(3)).

You do not have precise information as to Gallagher-Heffernan. In the event that none of the specific criteria set forth in subdivisions (a) - (f) of Regulation 18702.2 apply, the company would be covered by the catchall provisions of subdivision (g). Pursuant to that subdivision, the decision would be material if the decision would result in an increase or decrease in gross revenues for a fiscal year of \$10,000 or more, reduce or increase expenses in a fiscal year by \$2,500 or more, or increase or decrease assets or liabilities by \$10,000 or more.

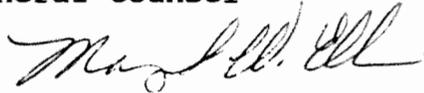
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If you have any questions concerning this letter, please contact me at (916)322-5901.

Sincerely,

Kathryn E. Donovan
General Counsel



By: Margaret W. Ellison
Counsel, Legal Division

KED:MWE:aa

Enclosures

MARSH, MARSH, VOLPE & MOLIN

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February 24, 1989

Diane Griffiths, General Counsel
FAIR POLITICAL PRACTICES COMMISSION
428 J Street, Suite 800
Sacramento, CA 95804

Re: **Special District Insurance Authority/Request
for Advice**

Dear Ms. Griffiths:

This office serves as general counsel to the Special District Insurance Authority (hereinafter referred to as SDIA). SDIA is a joint powers authority created and existing as an independent public entity pursuant to California Government Code §6500 et seq. The Authority provides various types of insurance coverage and risk pooling protections to its member districts. SDIA has adopted a conflict of interest code which has been submitted to and approved by your agency as the code reviewing body. The purpose of this letter is to request a formal opinion as to whether or not a proposed contractual relationship with the agencies consultant insurance broker poses a potential conflict of interest. The position of insurance broker is a designated position in SDIA's conflict of interest code.

SDIA has utilized the services of Arthur J. Gallagher (a public traded corporation) and Gallagher-Heffernan (its wholly owned subsidiary) (collectively referred to herein as "Gallagher") as its insurance broker for some period of time. Gallagher has placed insurance for and provided various types of insurance related advice to SDIA. In order to clarify the responsibilities of the agency and Gallagher relative to the insurance advice aspects of the relationship, SDIA desires to enter into separate agreements with Gallagher as to its broker and consultant responsibilities.

In a general sense, the broker contract would require Gallagher to search appropriate markets and to place insurance coverages as requested and directed by SDIA, as it is presently doing. Gallagher would be paid a fee and/or commission for this service as is appropriate. In addition to the aforementioned contract SDIA is contemplating entering into a separate contract with additional compensation, wherein Gallagher would be required to provide SDIA insurance and risk pooling advice. These services would include things such as attending governing board

Diane Griffiths, General Counsel
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meeting, assisting in drafting memorandum of coverages, providing advise as to risks to be covered and excluded, evaluating existing coverage, rating risk and assisting with calculating deposits (premiums). In fact, Gallagher is performing many of these services voluntarily without compensation at this time. However, SDIA would like to enter into a specific written compensation agreement for these services in order to establish a professional relationship and responsibility for these services. Obviously, to a certain extent in providing these services Gallagher will have an indirect financial interest in the outcome of decisions depending upon the placement of certain coverages. As an example, if a decision was made to eliminate excess insurance coverage on a particular risk or to drop a certain line of coverage, Gallagher could stand to lose the commission or fee paid for the placement of the excess coverage. However, these are the types of decision insurance and liability pools typically look to their insurance broker for input on.

Specifically, the questions presented are:

1. Does the contemplated relationship described above create a conflict of interest such that SDIA can not contract with Gallagher to provide the broker and consultant services described?; and

2. Assuming the contractual arrangements are permissible, under what circumstances should Gallagher disqualify itself from making recommendations and advice?

If you need any further information or material in order to issue an opinion, please feel free to contact us. We appreciate your cooperation.

Very sincerely yours,

MARSH, MARSH, VOLPE & MOLIN



HARRY M. MARSH

HMM:sb

cc: Richard K. Maddalena, Administrator
SPECIAL DISTRICT INSURANCE AUTHORITY

Gerald L. Lillis
GALLAGHER-HEFFERNAN



California Fair Political Practices Commission

March 2, 1989

Harry Marsh
Marsh, Marsh, Volpe & Molin
341 Broadway, Suite 221
P.O. Box 3590
Chico, CA 95927-3590

Re: Letter No. 89-130

Dear Mr. Marsh:

Your letter requesting advice under the Political Reform Act was received on February 27, 1989 by the Fair Political Practices Commission. If you have any questions about your advice request, you may contact Margaret Ellison an attorney in the Legal Division, directly at (916) 322-5901.

We try to answer all advice requests promptly. Therefore, unless your request poses particularly complex legal questions, or more information is needed, you should expect a response within 21 working days if your request seeks formal written advice. If more information is needed, the person assigned to prepare a response to your request will contact you shortly to advise you as to information needed. If your request is for informal assistance, we will answer it as quickly as we can. (See Commission Regulation 18329 (2 Cal. Code of Regs. Sec. 18329.)

You also should be aware that your letter and our response are public records which may be disclosed to the public upon receipt of a proper request for disclosure.

Very truly yours,

Diane M. Griffiths
General Counsel

DMG:plh