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State of California



Fair Political Practices Commission

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

December 27, 1976

A-76-547

Rose Elizabeth Bird
Secretary
Agriculture and Services Agency
1220 N Street
Sacramento, CA 95814

Dear Ms. Bird:

I have been asked to respond to your letter of August 27, 1976, requesting "an informal opinion on the continued viability of Section 11770 of the Insurance Code in light of the passage of Proposition 9."

I. Background

California employers are subject to compulsory liability for injuries sustained by employees in the course of their employment. When compulsory liability was instituted in the early 1900's, the California Constitution¹ authorized creation of a State Compensation Insurance Fund to insure that employers could obtain insurance against this liability at a reasonable cost. Pursuant to this constitutional authorization, the Legislature created a State Compensation Insurance Fund (hereinafter the "Fund") to be administered by a five person board of directors. (Ins. Code Section 11770) In providing this insurance coverage, the Fund is to compete directly with private insurers for business and is to be self supporting but not make profits (Ins. Code Section 11775). This insures employers access to liability insurance at cost, prevents a private insurance monopoly and provides a "yardstick" by which employers can measure "fair" premium rates. The Fund is required to return, either in the form of cash or credit (against renewal premiums) dividends, any excess of assets over liabilities after providing for necessary reserves and a reasonable amount for catastrophic hazards (Ins. Code Section 11776). The Board of Directors decides whether to declare a dividend, whether it will be cash or credit, the amount of the dividend and what proportion of the surplus is to be returned to each employer (Ins. Code Section 11777).

The Board of Directors of the Fund is composed of the

¹/Cal. Const., Article XX, Section 19.

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Director of the Department of Industrial Relations, who acts as chairman, and four members appointed by the Governor. To be eligible for appointment, a person must have been either a policyholder (an employer) or an employee of a policyholder in the Fund for at least one year prior to the appointment and must continue in that status during the period of membership (Ins. Code Section 11770).

With regard to the four gubernatorial appointments, there are no statutory restrictions concerning how many, if any, must represent public or private policyholders, or how many, if any, must be employees of policyholders. Thus, all four appointed members could be private policyholders and, at the present time, they are.

II. Analysis

Government Code Section 87100^{2/} establishes the basic conflict of interest prohibition and provides:

No public official at any level of state or local government shall make, participate in making or in any way attempt to use his official position to influence a governmental decision in which he knows or has reason to know he has a financial interest.

Section 82048 defines "public official" to mean every member, officer, employee or consultant of a state or local government agency. Hence, if the Fund is a state agency, the members of the Board of Directors are public officials and are subject to the strictures of Section 87100.

Section 82049 defines "state agency" to include "... every state office, department, division, bureau, board and commission, and the Legislature,..." To further clarify the meaning of this section, the Fair Political Practices Commission adopted 2 Cal. Adm. Code Section 18249 which provides:

An agency is a state agency within the provisions of Government Code Section 82049 only if all the following criteria are met:

(a) The agency is authorized by statute, executive order or the California constitution.

^{2/}All citations are to the Government Code unless otherwise indicated.

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(b) At least one voting member is an elected state officer or is appointed by an elected state officer or an agency official or a state agency.

(c) The agency is financed in part by any state funds or is subject to appropriation in the state budget.

(d) An area larger than one county is included in its jurisdiction.

Each of the stated criteria is satisfied in the case of the Fund. It is authorized by the Constitution and by statute, four of the five members of the Board of Directors are appointed by the Governor, the agency is subject to appropriation in the state budget^{3/}, and the agency's jurisdiction is the State of California. In addition, California case law makes it quite clear that, although unique, the State Compensation Insurance Fund is a "state agency." See Gilmore v. State Compensation Insurance Fund (1937) 73 P.2d 640, 23 C.A.2d, 325. See also 15 Ops. Atty. Gen. 210.

Having concluded that the fund is a state agency and that its members, therefore, are public officials, the next question is whether any of the members have the requisite "financial interest" to trigger the provisions of Section 87100 and the disqualification provisions of the Conflict of Interest Code to which they are or will be subject.^{4/} Section 87103 defines "financial interest," both for purposes of the Section 87100 prohibition and for disqualification pursuant to the provisions of a conflict of interest code:

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:

(a) Any business entity in which

^{3/}Insurance Code Section 11773 provides that the State Compensation Insurance Fund shall consist of: "(a) such specific appropriations as the Legislature from time to time makes or sets aside for the use of the fund."

^{4/}Section 87300 requires every state agency to adopt a Conflict of Interest Code which mandates "designated employees" subject to the Code to disqualify themselves from making or participating in making decisions which foreseeably may materially affect their own financial interests. Section 87302(c)

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the public official has a direct or indirect investment worth more than one thousand dollars (\$1,000);

(b) Any real property in which the public official has a direct or indirect interest worth more than one thousand dollars (\$1,000);

(c) Any source of income, other than loans by a commercial lending institution in the regular course of business, aggregating two hundred fifty dollars (\$250) or more in value received by or promised to the public official within twelve months prior to the time when the decision is made; or

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

For purposes of this section, indirect investment or interest means any investment or interest owned by the spouse or dependent child of a public official, by an agent on behalf of a public official, by any business entity controlled by the public official or by a trust in which he has a substantial interest. A business entity is controlled by a public official if the public official, his agents, spouse and dependent children hold more than fifty percent of the ownership interest in the entity. A public official has a substantial interest in a trust when the official, his spouse and dependent children have a present or future interest worth more than one thousand dollars (\$1,000).

Section 82030(b)(2) excludes salary received from a state agency from the definition of income. Accordingly, unless the Director of the Department of Industrial Relations, who serves as chairman of the Fund's Board, receives income from a source other than the state, he will not affect a "source of income" within the meaning of Section 87103(c) when he makes or participates in Fund decisions.^{5/}

^{5/}We have not been provided with any information relative to whether the Director has "investment," "real property," or "management" interests which may be affected and hence, cannot comment on whether he must disqualify himself from certain decisions by virtue of these interests.

The other four members of the Board, on the other hand, must be policyholders (employers) or employees of policyholders of the Fund. For these members the policyholder, when it is in the private sector, undoubtedly will be a source of income (Section 87103(c)) and a business entity in which they hold a management or employee position (Section 87103(d)). Moreover, the decision to declare a dividend payable to the private sector policyholder will have a financial effect on the policyholder. If it is reasonably foreseeable that the dividend decision will have a "material" financial effect on the policyholder, distinguishable from its effect on the public generally, it will be necessary for the member whose company will be so affected to disqualify himself from making or participating in the dividend decision.

The concept of materiality has been clarified by the Commission by regulation. 2 Cal. Adm. Code Section 18702 provides, in pertinent part:

(a) The financial effect of a governmental decision on a financial interest of a public official is material if, at the time the official makes, participates in making or attempts to use his or her official position to influence the making of the decision, in light of all the circumstances and facts known at the time of the decision, the official knows or has reason to know that the existence of the financial interest might interfere with the official's performance of his or her duties in an impartial manner free from bias.

(b) In determining the existence of a material effect upon a financial interest, consideration should be given, but not be limited to, an analysis of the following factors:

(1) In the case of a business entity in which the public official has a direct or indirect investment worth more than one thousand dollars (\$1,000), or in the case of a public official who is a director, officer, partner, trustee, employee, or holds any position of management in a business entity:

(A) Whether the effect of the decision will be to increase or decrease the annualized gross revenue of the business entity by one percent or more or the annual net income of the business entity by .5 percent or more;

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(B) Whether the effect of the decision will be to increase or decrease the assets or liabilities of the business entity by \$50,000 or more, or by .5 percent of its current assets or liabilities, whichever is less.

* * * *

(3) In the case of a source of income of a public official as defined in Government Code Section 87103(c):

(A) The decision will affect the source of income in the manner described in subsection (b)(1) above;

(B) Whether the governmental decision will directly affect the amount of income to be received by the official;

(C) Whether there is a nexus between the governmental decision and the purpose for which the official receives income.

The specific dollar or percentage amounts set forth above do not constitute either absolute maximum or minimum levels, but are merely intended to provide guidance and should be considered along with other relevant factors in determining whether a financial interest may interfere with the official's exercise of his or her duties in rendering a decision.

Turning to the specific guidelines first, it is necessary to analyze certain factual information to determine whether they are apposite. For example, although some policyholders pay only a few dollars per annum in premiums for Fund coverage, others pay as much as \$300,000 to \$400,000 per annum.^{6/} Moreover, a policyholder with a good record can receive an annual dividend which equals 40 to 50 percent of the premiums paid. Accordingly, a dividend decision by the Fund's Board could return several hundred thousand dollars in cash or credit to a company which is a source of income to a director or in which the director holds an employment position. If the dividend increased or decreased the annual net income of the company by .5 percent or more, the financial effect of the decision to declare the dividend would fall within the guideline. Similarly, ^{6/}These figures, and others referred to herein, were provided by a representative of the State Compensation Insurance Fund.

if the decision increased or decreased the assets or liabilities of the company by \$50,000 or more, or by .5 percent of its current assets or liabilities, whichever is less, the financial effect of the decision would be within the guideline.

However, even if the dividend decision did not result in the financial impact specified by the guideline, the decision nevertheless might be "material." As indicated in 2 Cal. Adm. Code Section 18702(a), the ultimate test in determining materiality is whether the member of the Fund's Board can make or participate in dividend decisions "in an impartial manner free from bias." In light of the amounts of money involved and the relationship between the Board member and the policyholder, it is questionable whether the Board member could maintain the required impartiality.^{7/}

We observe, moreover, that to the extent a dividend decision will have a "material" financial effect, that effect will be distinguishable from the effect of the decision on the public generally. The "public generally" is not insured by the Fund, does not pay premiums to the Fund and does not receive cash or credit dividends from the fund. A dividend decision, therefore, has a unique effect on policyholders which is distinguishable from the effect the decision has on the public generally.^{8/}

Accordingly, it is possible that a director of the Fund who is either a private employer policyholder or an employee of a private employer policyholder will have a financial interest in a dividend decision within the meaning of Section 87103. When this is the case, that director must disqualify himself from participation in Board decisions related to the declaration of the dividend. Section 87100.

One final clarification should be added to this conclusion. If a director were a public employer policyholder or an

^{7/}We have not been provided with facts which enable us to determine whether the criteria in 2 Cal. Adm. Code Section 18702(b)(3)(B) and (C) are present in the context of dividend decisions. However, as the regulation indicates, these criteria are only guidelines to which "consideration should be given" and are not determinative. Accordingly, materiality can be present regardless of a direct effect on the amount of income received by the official or a nexus between the governmental decision and the purpose for which the official receives income. See opinion requested by Iris Sankey, 2 FPPC Opinions ___ (No. 76-071, Nov. 3, 1976).

^{8/}2 Cal. Adm. Code Section 18703 interprets the phrase "public generally" to include a "significant segment of the public." It is doubtful, however, that employers who carry insurance through the Fund are a significant segment of the public.

Rose Elizabeth Bird

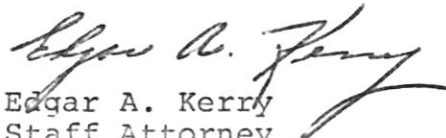
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employee of a public employer policyholder, neither the source of income interest nor the management position interest upon which we have based the foregoing advice would be present to create the necessary "financial interest" required by Section 87103. In this situation, the director's income would be from a state or local government agency and would not be within the Section 82030 definition of income and the employment or management position held would not be with a "business entity" within the meaning of Section 82005. Accordingly, absent an investment or real property interest sufficient to bring the director within the definition of "financial interest" in Section 87103, a director who is a public employer policyholder or an employee of a public employer policyholder would not be subject to disqualification from dividend decisions under Section 87100 or the conflict of interest disqualification provisions of a Code.

I hope that these informal remarks are responsive to your question. If I can be of further assistance to you in this matter, please let me know.

Sincerely,



Edgar A. Kerry
Staff Attorney
Conflict of Interest Division

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AGRICULTURE AND SERVICES AGENCY

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August 27, 1976

Mr. Michael Bennett
Executive Director
Fair Political Practices
Commission
P.O. Box 807
Sacramento, CA 95814

Dear Mr. Bennett:

We hereby request an informal opinion on the continued viability of Section 11770 of the Insurance Code in light of the passage of Proposition 9.

Section 11770 specifies that all members of the Board of Directors of the State Compensation Insurance Fund, other than the Director of the Department of Industrial Relations, shall be policyholders or employees of policyholders. A copy of Section 11770 is attached.

The State Compensation Insurance Fund is a part of the Department of Industrial Relations and was established to transact workers compensation insurance. The Fund is administered by its Board of Directors. The Board sets insurance rates for policyholders, awards dividends, etc.

Although the State Compensation Insurance Fund is clearly a state agency, Section 11781 of the Insurance Code provides that the Board of Directors "may perform all acts necessary or convenient in the exercise of any power, authority, or jurisdiction over the Fund...as fully and completely as the governing body of a private insurance carrier."

Thank you for your consideration.

Sincerely,
Rose E. Bird

Rose Elizabeth Bird
Agency Secretary

Attachment

DEPARTMENTS OF THE AGENCY

FOOD AND AGRICULTURE

CONSUMER AFFAIRS

STATE PERSONNEL BOARD

FRANCHISE TAX BOARD

GENERAL SERVICES

CHAPTER 4. THE STATE COMPENSATION INSURANCE FUND.

Article 1. Organization and Powers.

11770. [36, amended 1945, 1947, 1969] The State Compensation Insurance Fund is continued in existence, to be administered by its board of directors for the purpose of transacting workmen's compensation insurance, and insurance against the expense of defending any suit for serious and willful misconduct, against an employer or his agent, and insurance to employees and other persons of the compensation fixed by the workmen's compensation laws for employees and their dependents. Any appropriation made therefrom or thereto before the effective date of this code shall continue to be available for the purposes for which it was made.

The board of directors of the State Compensation Insurance Fund is composed of the Director of Industrial Relations, who is chairman thereof, and four members who shall be appointed by the Governor. The term of office of the members of the board, other than that of the director, shall be four years and they shall hold office until the appointment and qualification of their successors. The terms of the first four members so appointed shall expire as follows: one on January 15, 1946; one each on January 15, 1947, January 15, 1948, and January 15, 1949. Each member shall receive his actual and necessary traveling expenses incurred in the performance of his duty as a member and, except the Director of Industrial Relations, twenty-five dollars (\$25) for each day of his actual attendance at meetings of the board. In order to qualify for membership on the board, each member other than the director shall have been a policyholder or the employee of a policyholder in the State Compensation Insurance Fund for one year prior to his appointment, and must continue in such status during the period of his membership.

Anno. Ins. §§ 11770-11881: Hanna, Cal. Law of Emp. Inj., Vol. 1, §§ 2.04[4]; 2.04[14][b]; Vol. 2, §§ 17.02[1]; 20.01[1][b]; 20.02[1]; 20.02[2][a]; 21.02[3][g]; 21.03[6][b].

11770.5. [Added 1967] The provisions of Article 9 (commencing with Section

Worker's Compensation Act, or other federal or maritime laws when written incidental to and in connection with California Workmen's Compensation, as fully as any private insurer.

Anno. Ins. § 11779: Hanna, Cal. Law of Emp. Inj., Vol. 1, § 2.04[7]; Vol. 2, § 21.01[21][d].

11780. [36½] The fund may also insure an employer against his liability for damages under the laws of the State of California arising out of bodily injury to or death of his employees occurring within the State of California if the fund also issues workmen's compensation insurance to the employer as to his employees.

Anno. Ins. § 11780: Hanna, Cal. Law of Emp. Inj., Vol. 1, § 2.04[7]; Vol. 2, § 21.03[21][c].

11781. [38(a), amended 1945] The board of directors is hereby vested with full power, authority and jurisdiction over the State Compensation Insurance Fund. The board of directors may perform all acts necessary or convenient in the exercise of any power, authority or jurisdiction over the fund, either in the administration thereof or in connection with the insurance business to be carried on by it under the provisions of this chapter, as fully and completely as the governing body of a private insurance carrier. The principal office for the transaction of business of the State Compensation Insurance Fund is located in the City and County of San Francisco.

Anno. Ins. § 11781: Hanna, Cal. Law of Emp. Inj., Vol. 1, §§ 2.04[4]; 2.04[12].

11781.5 [Enacted 1946] The State Compensation Insurance Fund may acquire and own real property for a branch office in the City of Los Angeles when so determined by the board of directors, and may, if necessary, construct suitable buildings thereon in accordance with law.

11782. [38(b), amended 1945] All business and affairs of the fund shall be conducted in the name of the State Compensation Insurance Fund, and in that name, without any other name or title, the board of directors may perform the acts authorized by this chapter.

11783. [38(b), amended 1945] The State Compensation Insurance Fund may:

(a) Sue and be sued in all actions arising out of any act or omission in connection with its business or affairs.

(b) Enter into any contracts or obligations relating to the State Compensation Insurance Fund which are authorized or permitted by law.

(c) Invest and reinvest the moneys belonging to the fund as provided by this chapter.

(d) Conduct all business and affairs and perform all acts relating to the fund whether or not specifically designated in this chapter.

Anno. Ins. § 11783: Hanna, Cal. Law of Emp. Inj., Vol. 1, § 2.04[11].

11784. [39, amended 1945] In conducting the business and affairs of the fund, the manager of the fund may:

(a) Enter into contracts of workmen's compensation insurance.

(b) Sell annuities covering compensation benefits.

(c) Decline to insure any risk in which the minimum requirements of the industrial accident prevention authorities with regard to construction, equipment and operation are