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CHAIRMAN



FAIR POLITICAL PRACTICES COMMISSION

July 15, 1996

A. Byrne Conley
Gibbons, Lees & Conley
1850 Mt. Diablo Boulevard, Suite 600
Walnut Creek, California 94596-4498

Re: Your Request for Advice
Our File No. A-96-182

Dear Mr. Conley:

This is in response to your request for advice dated May 31, 1996, regarding the conflict-of-interest provisions of the Political Reform Act (the "Act").¹ You are counsel to the Central Coast Cities Self-Insurance Fund ("CCCSIF"). Your request for advice relates to the Montandon Advice Letter, No. A-96-060, regarding the CCCSIF.

QUESTIONS

1. If the CCCSIF deletes the listing of "Plan Administrator" as a "designated employee" under its conflict of interest code, would Mike Simmons and/or Marilyn Kelley be considered a "public official" under Sections 87100 et seq.?
2. If the CCCSIF Board removes Insurance Company of the West ("ICW") from consideration in procuring insurance this year, may Sedgwick employees continue to participate in the making of a governmental decision to procure insurance under Regulation 18700(c)?
3. If the contract between the CCCSIF and Sedgwick James of California, Inc., was amended to specifically sanction the consideration of carriers using Sedgwick-related managing agents or underwriters (i.e., S.J. Petrakis), upon full disclosure of the relationship and income generated, would this eliminate the conflict of interest discussed in the Montandon letter?

¹ Government Code Sections 81000-91015. Commission regulations appear at Title 2, Sections 18000-18995 of the California Code of Regulations.

CONCLUSIONS

1. Yes. Employees of Sedgwick providing the services to the CCCSIF described below are consultants under Regulation 18700(a)(2)(B), because they are serving in a staff capacity to the CCCSIF. As such, they are properly designated in the CCCSIF's conflict of interest code, must file statements of economic interests, and may not participate in a governmental decision in which they have a financial interest.

2. We confirm that if the CCCSIF Board removes ICW from consideration in procuring insurance, Sedgwick employees may continue to participate in making a governmental decision to procure insurance, as discussed on pages 5-7 of the Montandon letter.

3. No. Under the Act, Sedgwick employees cannot participate in making a governmental decision if it is reasonably foreseeable that the decision will have a material financial effect on Petrakis, a business entity which is "otherwise related" to Sedgwick under Regulations 18236 and 18706. This conclusion would not be altered if the contract between Sedgwick and the CCCSIF was amended to sanction the consideration of insurance carriers using Sedgwick-related managing agents and to disclose the relationship and income generated.

FACTS

The CCCSIF is a joint powers authority ("JPA") formed to combine the purchasing power of eleven cities to acquire insurance. The CCCSIF is an independent government entity with its own conflict of interest code. It is governed by a board of directors who are appointed by each of the eleven city members.

The CCCSIF has no staff of its own. It contracts for services with different entities, individuals, and corporations. Sedgwick is an insurance brokerage company. Pursuant to the Brokerage, Risk Management and Program Administration Contract dated as of July 1, 1995, between Sedgwick and the CCCSIF, as amended May 2, 1996 (the "Brokerage Contract"), Sedgwick acts as the broker and program administrator of the JPA.

Under the Brokerage Contract, Sedgwick's compensation was initially structured as a mixture of commission income and hourly fees, subject to a total cap per year. For contract year one, the cap was \$175,000. The Brokerage Contract was amended as of May 2, 1996, to restructure Sedgwick's income. Under the amended contract, Sedgwick no longer receives commission income. Instead, it receives an "administrative fee" and a "program fee" payable by each of the eleven cities. For contract year two, the cap is \$175,000.

From 1990 to 1995, the CCCSIF purchased insurance from ICW. The CCCSIF purchased this insurance through S.J. Petrakis

Insurance Services, Inc. S.J. Petrakis is the managing general agent of ICW in California, performing underwriting services for ICW. The relationship between Sedgwick James of California, Inc., and Petrakis is as follows. Sedgwick James of California, Inc., is a wholly owned subsidiary of Sedgwick, Inc. S.J. Petrakis is a corporation, with 90 percent of its stock owned by Sedgwick, and 10 percent of its stock owned by Steven J. Petrakis. Thus, Sedgwick James of California, Inc., and Petrakis are "sister" companies, owned by a common parent. None of the three are publicly traded companies, as Sedgwick James, Inc., is in turn a wholly owned subsidiary of Sedgwick Group, PLC, a publicly traded company on the London Stock Exchange.

In the Montandon letter, we advised that the Sedgwick consultants would have a conflict if they made a decision that would have a material financial effect on S.J. Petrakis. The Montandon letter, your own review of the statutes, regulations and conflict of interest code adopted by the CCCSIF, and the information provided by Sedgwick, leads you to believe that the renewal of insurance with ICW would give rise to a potential conflict of interest under the CCCSIF conflict of interest code. This is because the CCCSIF has listed its "Plan Administrator" as a "designated employee" covered by Regulation 18730, subdivision 9. Sedgwick is the plan administrator of the CCCSIF.

You note that Marilyn Kelley is not Secretary to the JPA. The reference to "secretary" of the JPA in the Sedgwick James of California, Inc., contract refers entirely to clerical functions. The CCCSIF has an elected Secretary/Treasurer, who is Bill Statler of the City of San Luis Obispo. Further, Sedgwick employees do not make any governmental decisions under Regulation 18700(a)(2). Instead, all such decisions are reserved exclusively to the CCCSIF Board of Directors, or Executive Committee.

You state that S.J. Petrakis is of such a size that Regulation 18702.2(f) appears to apply, so that a decision resulting in an increase in gross revenues to S.J. Petrakis of \$30,000 or more results in a material effect to S.J. Petrakis, a related company of Sedgwick James of California, Inc.

At the June 12, 1996 meeting, the CCCSIF Board voted to exclude ICW from consideration in its insurance placement for the 1996-1997 fiscal year. The Board instead voted to place coverage with a member of the American Insurance Group which has no ties to Sedgwick, directly or indirectly.

This raises some practical problems for the CCCSIF. Clearly, the CCCSIF wishes to comply with the Act and regulations, and avoid any conflict of interest. However, the member cities also have a financial interest in full access to the insurance market, so as to make the best deal possible for coverage.

ANALYSIS

The Act provides that no public official at any level of state or local government shall make, participate in making or in any way attempt to use his or her official position to influence a governmental decision in which the official has a financial interest. (Section 87100.)

1. Public Officials. You ask whether Sedgwick employees who provide the services described below to the CCCSIF are considered public officials. The term "public official" includes every member, officer, employee or consultant of a state or local government agency. (Section 82048.) Accordingly, if Sedgwick employees are "consultants" within the meaning of the Act, they may not make, participate in making, or in any way use their position to influence, a governmental decision which affects their financial interest.

In 1994, Regulation 18700(a)(2) was amended to provide a new definition of "consultant." Under this definition, an individual is a consultant if, pursuant to a contract with a state or local governmental agency, the individual:

- (A) Makes a governmental decision whether to:
 - (i) Approve a rate, rule, or regulation;
 - (ii) Adopt or enforce a law;
 - (iii) Issue, deny, suspend, or revoke any permit, license, application, certificate, approval, order, or similar authorization or entitlement;
 - (iv) Authorize the agency to enter into, modify, or renew a contract provided it is the type of contract which requires agency approval;
 - (v) Grant agency approval to a contract which requires agency approval and in which the agency is a party or to the specifications for such a contract;
 - (vi) Grant agency approval to a plan, design, report, study, or similar item;
 - (vii) Adopt, or grant agency approval of, policies, standards, or guidelines for the agency, or for any subdivision thereof; or

(B) Serves in a staff capacity with the agency and in that capacity performs the same or substantially all the same duties for the agency that would otherwise be performed by an individual

holding a position specified in the agency's Conflict of Interest Code.

You state that Sedgwick employees do not make any of the decisions set forth in Regulation 18700(a)(2)(A). According to your facts, all such decisions are reserved exclusively to the CCCSIF Board of Directors, or Executive Committee. However, it appears that Sedgwick employees may serve in a staff capacity with the agency and in that capacity perform the same or substantially all the same duties for the agency that would otherwise be performed by an individual holding a position specified in the agency's conflict of interest code.

The test established in Regulation 18700(a)(2)(B) is a two-fold test, both of which must be satisfied for an individual to qualify as a consultant. A staff memorandum to the Commission discussed the intent of the "staff capacity" language in this regulation:

[T]he Commission wishes to include within the scope of the regulation only those individuals who are performing substantially all the same tasks that normally would be performed by one or more staff members of a governmental entity. The first prong, the "staff capacity" language, eliminates in most cases from the scope of the regulation those individuals who work on one project or a limited range of projects for an agency. In addition, there is a temporal element to the qualifier. For example, an individual who contracted with a city to study noise at a specified intersection normally would not be serving in a staff capacity if he or she took the measurements in one day and issued a report to the planning commission before its next meeting. If, however, a firm's contract provided that it would provide all plan checking services for a city for five years, it is much more likely that individuals performing these services would be in a quasi-staff capacity.

The second prong of the test adds an additional condition: the tasks of the quasi-staff member over this period of time must be substantially the same as one of the individuals whose position at the agency is described in the Conflict of Interest Code.

(March 28, 1994 memorandum to the Commission regarding Regulation 18700, pages 3 and 4.)

Section 87300 of the Act requires every agency to adopt a conflict of interest code. An agency's conflict of interest code has the force of law and any violation of the conflict of interest code by a designated employee is deemed a violation of Chapter 7 of the Act. Section 87302 requires that each agency's conflict of interest code must specifically enumerate the positions within the

agency that involve the making or participation in the making of decisions which may foreseeably have a material effect on any financial interest.

Of the letters interpreting the new definition of consultant, the Randolph Advice Letter, No. I-95-045 (copy enclosed), is most applicable. There we advised that employees of an investment firm which provided consulting services to a county employee's retirement association were consultants under the Act who should be listed in the agency's conflict of interest code, and must file statements of economic interests. Pursuant to a contract, employees of the investment consultant attended all board meetings and meetings of standing committees of the board, in which investments and issues relating to investments were discussed, and the investment consultant's advice and input was requested. In addition, employees of the investment consultant were required to perform other services and provide reports on investment issues that might be requested by the retirement board or staff from time to time. We concluded that the employees of the investment advisor served on an ongoing basis as staff for the retirement board and in that capacity participated in the making of all investment decisions.

Sedgwick employees prepare and present reports or opinions regarding insurance coverage levels and policy quotations which require the exercise of judgment on their part as set forth in Regulation 18700(c)(2)(B). For example, Sedgwick employees prepared reports titled the "CCCSIF FY 95/96 Renewal Marketing Results and Funding Recommendations" and the "CCCSIF Excess Liability Coverage Details" for a June 14, 1995 CCCSIF Board meeting. These reports summarized and compared quotes from several insurance companies and made recommendations as to which coverages and policies to select. The purpose of such reports is to influence a governmental decision referenced in Regulation 18700(a)(2)(A) -- namely, the CCCSIF board's decisions to procure insurance. Sedgwick employees influence decisions regarding policies, standards, and guidelines of the JPA as well. (Regulation 18700(a)(2)(A)(vii).)

These types of services constitute the "participation" in decisions and if the same services were performed by an employee of the CCCSIF, the employee would be designated in the conflict of interest code.² And in fact, the CCCSIF does designate the positions of "Plan Administrator" and "Consultants" in its

² An individual who advises or makes recommendations to the decisionmaker either directly or without significant intervening substantive review, either by conducting research or making any investigation for the purpose of influencing the decisionmaker or preparing or presenting any report, analysis, or opinion, orally, or in writing, for the purpose of influencing a governmental decision, is participating in making a governmental decision. (Regulation 18700(c).)

conflict of interest code.³ Accordingly, the employees of Sedgwick who provide such services to the CCCSIF are consultants under the Act. As such, they should continue to be designated in the CCCSIF's conflict of interest code and are subject to the provisions of the Act.

2. Removal of ICW from Consideration. We confirm that if the CCCSIF Board removes ICW from consideration in procuring insurance, Sedgwick employees may continue to participate in making a governmental decision to procure insurance, as discussed on pages 5-7 of the Montandon letter.

3. Sedgwick's Procuring Insurance Through S.J. Petrakis. Under the Act, it would normally give rise to a conflict for the consultants to be recommending insurance coverages and carriers and then receiving income for purchasing the policies. The consultants would be participating in making a governmental decision which affected a financial interest of theirs. (See Section 87103; Moe Advice Letter, No. 89-454; and Marsh Advice Letter, No. I-89-130.) In the Montandon letter and McEwen Advice Letter, No. I-92-481, however, we have advised that in certain limited circumstances where a governmental entity has entered into a contract to permit a consultant to make recommendations that result in the rendering of specifically identified services for an agreed upon price, a conflict of interest may not arise.

As the Montandon letter notes, the Brokerage Contract specifically provides that Sedgwick will recommend insurance coverages and procure insurance for the CCCSIF. In addition, the contract sets forth the total compensation Sedgwick can receive per fiscal year and enumerates all of Sedgwick's contemplated duties. The Board of Directors of the CCCSIF votes to approve the insurance coverages and the carriers recommended by Sedgwick. We concluded that under these circumstances, Sedgwick's receipt of commission income for procuring insurance on behalf of the JPA would not give rise to conflicts of interests for the consultants. This is because the JPA's decision to pay Sedgwick a set amount for procuring insurance was already made by the JPA's board. Therefore, the consultants' actions in influencing a governmental decision will not have a foreseeable financial effect on their employer Sedgwick. Without this limited exception, the consultants would be prohibited from recommending coverages and procuring insurance for the JPA. They would be unable to accomplish the primary task which they had been hired as consultants by the JPA board to perform.

In the Montandon letter, we concluded that the Sedgwick consultants would have a conflict if they recommended that the CCCSIF buy insurance from ICW through the managing general agent Petrakis, a related business entity. You ask whether the conflict

³ Under the Act, a "consultant" is the natural person providing services to the JPA, not the business entity Sedgwick.

would be absolved if the Brokerage Contract were amended to specifically disclose the relationship between Sedgwick and S.J. Petrakis, and the income earned by S.J. Petrakis if Sedgwick procured ICW insurance through that company.

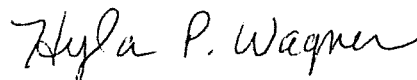
You state that the CCCSIF has an economic interest in unrestricted access to the insurance market. It seeks to obtain the best coverage at the best price. Knowing Sedgwick's relationship to S.J. Petrakis, the Board might still wish to consider ICW as a carrier in the future.

However, mere disclosure of a conflict and ratification by an agency's board does not remedy a conflict under the Act. The California Supreme Court stated as follows in Thompson v. Call: "The case law supports strict interpretation of conflict-of-interest statutes. Mitigating factors -- such as Call's disclosure of his interest in the transaction, and the absence of fraud -- cannot shield Call from liability." (1985) 38 Cal.3d 633, 650, footnote omitted. (See also Campagna v. City of Sanger (1996) 42 Cal.App.4th 533.) The rationale for the limited exception set forth in the McEwen letter does not apply to the Sedgwick consultants procuring insurance through S.J. Petrakis, a related business entity.

I trust this answers your question. If you have any further questions regarding this matter, please contact me at 916/322-5660.

Sincerely,

Steven G. Churchwell
General Counsel



By: Hyla P. Wagner
Counsel, Legal Division

SGC:HPW:ak

Enclosure