STATE OF CALIFORNIA
FAIR POLITICAL PRACTICES COMMISSION
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August 2, 2016

Mona M. Nemat, Esq
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200 South Main Street, Suite 307
Corona, CA 92882

Re: Your Request for Advice
Our File No. A-16-145

Dear Ms. Nemat:

This letter responds to your request for advice on behalf of Nancy Horton, elected member of the Elsinore Valley Municipal Water District Board ("District Board"), regarding Government Code section 1090, et seq.[1] Please note that we do not advise on any other area of law, including Public Contract Code or common law conflicts of interest. We are also not a finder of fact when rendering advice (*In re Oglesby* (1975) 1 FPPC Ops. 71), and any advice we provide assumes your facts are complete and accurate.

In regard to our advice on Section 1090, we are required to forward your request and all pertinent facts relating to the request to the Attorney General's Office and the County District Attorney's Office, which we have done. (Section 1097.1(c)(3).) We did not receive a written response from either entity. (Section 1097.1(c)(4).) We are also required to advise you that, for purposes of Section 1090, the following advice "is not admissible in a criminal proceeding against any individual other than the requestor." (See Section 1097.1(c)(5).)

QUESTION

Does Section 1090 prohibit the District Board from approving a settlement agreement in ongoing litigation if Board Member Horton has a financial interest in the settlement agreement?

CONCLUSION

No. As explained below, so long as Board Member Horton does not participate in approving the settlement, the District Board may approve a settlement agreement between the District and the property owner's association.

FACTS

Nancy Horton is an elected member of the Elsinore Valley Municipal Water District Board (the "District Board"), representing one of five districts represented by the Board. Her district

[1] All further statutory references are to the Government Code unless otherwise specified.

includes the City of Canyon Lake. There are approximately 25,000 residents and 10,000 dwelling units within her district, and 10,600 residents and 4,800 units in the City.[2]

The residential area of the City is a gated community located around Canyon Lake ("the Lake"). The shoreline of the Lake and the property underlying the Lake are owned by the District, which utilizes the Lake as a drinking water reservoir. The Canyon Lake Property Owners' Association ("POA") leases the shoreline and a portion of the land underlying the water reservoir for recreational purposes. The current cost of the lease to the POA is $1.5 million per year. That cost, along with associated Lake costs, is identified as "Lake operation and maintenance" in the POA budget. Such costs are paid for from a variety of POA revenue sources, including but not limited to assessments, fines, fees and general income from food, beverage and rentals. The lease expires in 2022 and has been amended several times.

All property owners within Canyon Lake pay a monthly assessment to the POA $245 that provides for the maintenance of common areas (golf course, tennis courts, equestrian area, parks, roads, internal security etc.) and other services. The assessment for all property owners differs only in whether it is paid annually or monthly; it does not differ for lake front as opposed to non-lake front property. In addition, the POA also obtains revenues from fees for certain types of boats as well as fees for kayaks, canoes, etc. These sources of revenue, and others, are used to pay the Lake lease.

The portion of the Lake leased from the District is POA common area and thus available for the use of all Canyon Lake residents. Pursuant to the lease and the CC&R's, the POA administers lakeshore areas as common areas and issues encroachment permits for such areas.

Board Member Horton and her spouse own a house as joint tenants with right of survivorship within the city that is "lake front property." They also own the dock and seawall adjacent to the house but not the real property on which the dock and seawall are located. Those are located on the POA common area property leased from the District, and the Board Member and her spouse have an encroachment permit issued by the POA. Board member Horton and her spouse also own a boat that they use on the lake. They also pay the POA an additional $230 per year to use their boat in the Lake.

Prior to Board Member Horton's election to the District Board, the POA raised the issue to the District of a lease modification that would decrease the annual amount it owed by approximately $250,000. The idea was to use this offset for Lake maintenance. The two sides were unable to come to an agreement and litigation ensued. The District Board and the POA are now apparently proposing to settle the action. Although you do not know the terms of the proposed settlement, it is your assumption the lease would continue on the same terms and conditions. And even if the settlement resulted in decreased annual payments by the POA, it would be the sole decision of the POA Board whether to reduce assessments as a result of any savings, which would amount to approximately $50 per year for each of the 4,800 properties.

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[2] The Association considers there to be only one "property owner" per dwelling unit, so there are 4,800 "property owners" for Association voting purposes.

Martyn Advice Letter, No. I-15-012

After the initial idea of the lease modification had been raised but prior to the lawsuit between the District and the POA, Board Member Horton requested advice under the Political Reform Act's conflict of interest provisions requesting a determination as to whether she could participate in District Board decisions to modify its lease with the POA.

The advice letter first determined that Board Member Horton had two interests (real property and her personal finances) that could potentially prohibit her from any participation in the contract modification decision. We first determined that based on the potential for litigation, it was reasonably foreseeable that the decision would have a material financial effect on her real property interest:

> Your facts indicate that the decision to modify the lease will likely end in litigation and a complaint that the Association has breached the contract. This will undoubtedly affect market value. For instance, if the property were to go on the market, the litigation would have to be disclosed to potential buyers and this may affect the sales price of the property. Therefore, the facts support a finding of materiality under this test.

We then determined that based on the potential for litigation, it was also reasonably foreseeable that the decision would have a material financial effect on her personal finances:

> As previously discussed, the effect of the governmental decision would likely result in some measurable financial impact on Board Member Horton's personal finances, in the form of special assessments, fees or other costs that may be necessary to cover the costs of litigation. Therefore, the facts also support a finding of materiality under this test.

We therefore concluded that Board Member Horton would have a conflict of interest in the decision to modify the District lease with the POA and was prohibited from making or participating in making such a decision. You stated that she has at all times complied with the advice provided.

You are now requesting that we provide advice under Section 1090 concerning the potential settlement of the pending lawsuit between the District and the POA. You have specifically requested that we address the rule of necessity.

ANALYSIS

Section 1090 generally prohibits public officers, while acting in their official capacities, from making contracts in which they are financially interested. Section 1090 is concerned with financial interests, other than remote or minimal interests, that prevent public officials from exercising absolute loyalty and undivided allegiance in furthering the best interests of their agencies. (*Stigall v. Taft* (1962) 58 Cal.2d 565, 569.) Section 1090 is intended "not only to strike at

actual impropriety, but also to strike at the appearance of impropriety." (*City of Imperial Beach v. Bailey* (1980) 103 Cal.App.3d 191, 197.)

Under Section 1090, "the prohibited act is the making of a contract in which the official has a financial interest." (*People v. Honig* (1996) 48 Cal.App.4th 289, 333.) A contract that violates Section 1090 is void. (*Thomson v. Call* (1985) 38 Cal.3d 633, 646.) The prohibition applies regardless of whether the terms of the contract are fair and equitable to all parties. (*Id.* at pp. 646-649.)

We employ the following six-step analysis to determine whether Board Member Horton has a conflict of interest under Section 1090.

Steps One, Two, and Three: Is Board Member Horton subject to the provisions of Section 1090 and is there a contract at issue in which she will participate in making?

As a member of the District Board, Board Member Horton is subject to the provisions of Section 1090, as is the District Board itself. (See Section 1090.) Section 1090 applies to contracts subject to the general principles of contract law and is applied broadly to encompass many related transactions. (*People v. Honig*, *supra*, at p. 351 citing *Stigall*, *supra*, at pp. 569, 571.) Here, the decision at issue involves a potential settlement agreement between the District and the POA. As a general rule, an agreement to settle a lawsuit is treated as a contract. (See, e.g., *T. M. Cobb Co. v. Superior Court* (1984) 36 Cal. 3d 273, 280; *Weddington Productions, Inc. v. Flick*, (1998) 60 Cal. App. 4th 793, 810.)

Finally, any settlement agreement between the District and the POA would need approval from the District Board. Board Member Horton would therefore participate in the making of a contract.

Step Four: Does Board Member Horton have a financial interest in the contract?

Section 1090 prohibits a public official from making a contract in which he or she has a financial interest. An official is deemed to have a financial interest in a contract if he or she might profit from it in any way. Although Section 1090 does not specifically define the term "financial interest," case law and Attorney General opinions state that prohibited financial interests may be indirect as well as direct, and may involve financial losses, or the possibility of losses, as well as the prospect of pecuniary gain. (*People v. Vallerga* (1977) 67 Cal.App.3d 847, 867, fn. 5; *Terry v. Bender* (1956) 143 Cal.App.2d 198, 207-208; 85 Ops.Cal.Atty.Gen. 34, 36-38 (2002); 84 Ops.Cal.Atty.Gen. 158, 161-162 (2001).) The fact that the officer's interest "might be small or indirect is immaterial so long as it is such as deprives the [District] of his [or her] overriding fidelity to it and places him in the compromising situation where, in the exercise of his official judgment or discretion, he may be influenced by personal considerations rather than the public good." (*Terry v. Bender* (1956) 143 Cal.App.2d 198, 207-208.)

As mentioned above, we determined that Board Member Horton was prohibited from participating in decisions concerning the modification of the lease between the District and the POA because any litigation would undoubtedly affect market value of her home and result in special

assessments or other costs to cover the expense of litigation. For the same reasons, we find that she has a financial interest in any agreement settling the pending lawsuit.

Section 1090 attempts to prevent situations where an official might be influenced by personal considerations even where such considerations are small or indirect. In the present situation, as the owner of lakefront property, there can be little doubt that it is in Board Member Horton's personal interest to eliminate the negative cloud of litigation currently hanging over the City. In light of this, Board Member Horton has a financial interest in any agreement to settle the pending litigation between the District and the POA.

Step Five: Does either a remote or noninterest exception apply?

As a general rule, when Section 1090 is applicable to one member of a governing body of a public entity, as here, the prohibition cannot be avoided by having the interested board member abstain; the entire governing body is precluded from entering into the contract. (*Thomson v. Call*, *supra*, at pp. 647-649; *Stigall v. City of Taft*, *supra*, at p. 569; 86 Ops.Cal.Atty.Gen. 138, 139 (2003); 70 Ops.Cal.Atty.Gen. 45, 48 (1987).) However, the Legislature has created various statutory exceptions to Section 1090's prohibition where the financial interest involved is deemed to be a "noninterest," as defined in Section 1091.5, or a "remote interest," as defined in Section 1091.

If a "noninterest" is present, the contract may be made without the official's abstention, and generally a noninterest does not require disclosure. (*City of Vernon v. Central Basin Mun. Water Dist.* (1999) 69 Cal.App.4th 508, 514-515; 84 Ops.Cal.Atty.Gen. 158, 159-160 (2001).) If a "remote interest" is present, the contract may be made if (1) the official in question discloses his or her financial interest in the contract to the public agency, (2) such interest is noted in the entity's official records, and (3) the official abstains from any participation in the making of the contract. (Section 1091(a); 88 Ops.Cal.Atty.Gen. 106, 108 (2005); 83 Ops.Cal.Atty.Gen. 246, 248 (2000).)

The one exception that appears relevant to your facts is the remote interest under Section 1091(b)(15):

> That of a party[3] to litigation involving the body or board of which the officer is a member in connection with an agreement in which all of the following apply:
>
> (A) The agreement is entered into as part of a settlement of litigation in which the body or board is represented by legal counsel.
> (B) After a review of the merits of the agreement and other relevant facts and circumstances, a court of competent jurisdiction finds that the agreement serves the public interest.

[3] Board Member Horton is not a named party to the litigation but that fact should not preclude the remote interest from applying to this situation where the POA, of which she is a member, is the named party. It is clear from the legislative intent relating to Section 1091(b)(15) that as long as the three specified factors are satisfied, a settlement agreement in which an official has a financial interest should be allowed. (See Assem. Bill No. 2801 (2007-2008 Reg. Sess.) as amended Mar. 25, 2008 [key issue is whether "existing conflict of interest rules that prohibit public bodies from making contracts in which members have an interest (should) be modified to permit certain narrowly defined settlement agreements"].)

> (C) The interested member has recused himself or herself from all participation, direct or indirect, in the making of the agreement on behalf of the body or board.

Accordingly, Board Member Horton will have only a remote interest in any settlement agreement as long as the factors set forth in subdivisions (A) - (C) are satisfied. If that is the case, she must follow the requirements in Section 1091(a), and the District Board can approve the settlement agreement between the District and the POA without violating Section 1090.

Despite this determination, we continue with our analysis because you have asked that we specifically address the rule of necessity.

Step Six: Does the rule of necessity apply?

In limited cases, the "rule of necessity" has been applied to allow the making of a contract that Section 1090 would otherwise prohibit. (*Eldridge v. Sierra View Hospital Dist.* (1990) 224 Cal. App. 3d 311, 322.) The rule has been applied where public policy concerns authorize the contract and "ensures that essential government functions are performed even where a conflict of interest exists." (*Ibid.*; See also 69 Ops.Cal.Atty.Gen. 102, 109 (1986) [the "rule of necessity" has been applied in at least two specific types of situations: where the contract is for essential services and no source other than the one that triggers the conflict is available; and where the official or board is the only one authorized to act]; (88 Ops.Cal.Atty.Gen. 106, 110 (2005).) "The rule of necessity permits a government body to act to carry out its essential functions if no other entity is competent to do So . . .." (*Lexin, supra*, at p. 1097.)

For instance, the "rule of necessity" has been applied to allow a school board to enter into a memorandum of understanding with a teachers' association even when a board member is married to a tenured teacher and would have a financial interest in the contract. (69 Ops.Cal.Atty.Gen. 102 (1986).) Similarly, a community college board was allowed under the rule to negotiate with its faculty for salary and benefits even though a board member was a retired faculty member whose health benefits were tied to current faculty benefits. (89 Ops.Cal.Atty.Gen. 217 (2006).)

Here, any agreement between the District and the POA proposing to settle the pending litigation will have to be approved by the District Board. Assuming the District Board is the only entity authorized to act with respect to approving such settlements, the District would never have an opportunity to settle important litigation in this type of situation if Section 1090 operated to prohibit such action. If such were the case, the District would be forced to continue with the litigation resulting in more fees and costs that it would prefer to avoid. As we stated in the *Devaney* Advice Letter, No. A-14-142:

> Forcing parties to litigate claims they could settle out-of-court serves no recognizable public policy, and we believe that such an absurd result was never intended by the Legislature. Instead, in such circumstances, "we apply reason and practicality, and interpret the statute in accord with common sense and justice, and to avoid an absurd result. [Citations.]" (*Kono v. Meeker* (2011) 196 Cal.App.4th 81, 87-88.) Indeed, as one

> court has recognized, "There is an equally strong public policy . . . to encourage the settlement of controversies in preference to litigation. Our Supreme Court 'recognized a century ago that settlement agreements are highly favored as productive of peace and good will in the community,' as well as 'reducing the expense and persistency of litigation.' [[[Citation.] The need for settlements is greater than ever before. 'Without them our system of civil adjudication would quickly break down.'" (*Salmon Protection and Watershed Network v. County of Marin* (2012) 205 Cal. App. 4th 195, 201, citations omitted.)

We therefore find that the rule of necessity applies in this case to allow the District Board to carry out its essential duties of settling pending lawsuits assuming it is the only entity authorized to do so.

Accordingly, the District Board may approve any agreement to settle reached between the District and the POA. But Board Member Horton must disqualify herself from participating in this decision in her official capacity.

If you have other questions on this matter, please contact me at (916) 322-5660.

Sincerely,

Hyla P. Wagner
General Counsel

By: Jack Woodside
Senior Counsel, Legal Division

JW:jgl