



STATE OF CALIFORNIA
FAIR POLITICAL PRACTICES COMMISSION
1102 Q Street • Suite 3000 • Sacramento, CA 95811
(916) 322-5660 • Fax (916) 322-0886

October 17, 2018

Steven P. Rice
Chief Counsel
Los Angeles County
Employees Retirement Association
300 N. Lake Avenue
Pasadena, CA 91101

Re: Your Request for Advice
Our File No. A-18-203

Dear Mr. Rice:

This letter responds to your request for advice regarding the conflict of interest provisions of the Political Reform Act (the "Act")¹ and Government Code section 1090. Please note that we are 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. If this is not the case or if the facts underlying these decisions should change, you should contact us for additional advice.

Regarding 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 Los Angeles 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).)

QUESTIONS

1. Does Section 1090 prohibit the Los Angeles County Employees Retirement Association ("LACERA") Board, with participation by Trustee Sanchez, from entering a new contract with an existing asset manager if Trustee Sanchez's company enters into a consulting agreement with that asset manager?

2. Does the Act prohibit Trustee Sanchez from participating in governmental decisions involved with monitoring and oversight of an existing agreement between an asset manager and LACERA if her company enters into a consulting agreement with the asset manager?

¹ The Political Reform Act is contained in Government Code Sections 81000 through 91014. All statutory references are to the Government Code, unless otherwise indicated. The regulations of the Fair Political Practices Commission are contained in Sections 18110 through 18997 of Title 2 of the California Code of Regulations. All regulatory references are to Title 2, Division 6 of the California Code of Regulations, unless otherwise indicated.

CONCLUSIONS

1. Yes. As explained below, Section 1090 would prohibit both Trustee Sanchez and the LACERA board from entering any new contracts with the asset manager if her company enters into a consulting agreement with that asset manager. In addition, the prohibition under Section 1090 would apply to any decision to modify, extend, or renegotiate the existing contract between LACERA and the asset manager.

2. Yes. As explained below, the Act would prohibit Trustee Sanchez from participating in governmental decisions involved with the monitoring and oversight of the existing contract between LACERA and the asset manager because the decisions would have a reasonably foreseeable material financial effect on the asset manager.

FACTS AS PROVIDED BY THE REQUESTOR

You are Chief Counsel of LACERA seeking advice on behalf of the LACERA Board of Investments (“Board”), and Gina Sanchez, a trustee who sits on the Board.

LACERA is the independent public agency responsible for administering retirement benefits for the active and retired employees of the County of Los Angeles and certain other participating employers. It is governed by two boards, a Board of Retirement generally responsible for administration of the fund and a Board of Investments generally responsible for investment of the fund’s assets, which currently are approximately \$56 billion. This request concerns only the Board of Investments and Trustee Sanchez.

Board of Investments

The Board consists of nine trustees, four appointed by the Los Angeles County Board of Supervisors, four elected by the members, and the Los Angeles County Treasurer and Tax Collector, who sits ex officio. The appointed members are required to “have had significant experience in institutional investing, either as an investment officer of a bank, or trust company; or as an investment officer of an insurance company, or in active, or advisory, capacity as to investments of institutional or endowment funds.” (Gov. Code, § 31520.2(a).)

Trustee Sanchez

Trustee Sanchez is an appointed trustee on the Board. Her service as a trustee began on January 1, 2018 and terminates on December 31, 2020. She will be eligible for reappointment thereafter. As a trustee, Ms. Sanchez serves on the Board’s Equity Growth Committee (“Growth Committee”), which makes recommendations to the full Board with respect to various matters, including investment manager selection, oversight, management, and reporting relating to the public and private equities portion of LACERA’s portfolio.

Trustee Sanchez is the founder, Chief Executive Officer, and 75% shareholder of Chantico Global, LLC. Chantico, which was established in 2013, performs asset allocation modeling and serves as an asset allocation consultant to institutions and other clients. As a consultant, Chantico

provides its clients with strategic and tactical research, review, and counseling to assist in asset allocation and performs process research and review of investment policy-setting and decision-making. Trustee Sanchez's work for Chantico has continued throughout her period of service on LACERA's Board.

Asset Manager

One of LACERA's asset managers performs as a non-U.S. emerging markets public equity manager that manages approximately \$348 million for LACERA. LACERA has numerous managers across all of its other asset classes, which include private equity, hedge funds, real estate, commodities, and fixed income. The total portfolio is approximately \$56 billion across all asset classes. In overseeing the portfolio, Board decisions regarding emerging markets managers are evaluated and considered separately from managers responsible for other categories. As for oversight and monitoring, emerging markets managers are evaluated in three ways: 1) as a sub-category; 2) as part of the global equity portfolio; and 3) as part of the total LACERA fund.

The asset manager performs its services for LACERA pursuant to an Investment Management Agreement ("IMA"), which became effective as of January 14, 2013, several years before Trustee Sanchez became a LACERA trustee. The IMA with this asset manager, which had an initial 12-month term and renews automatically for successive 12-month terms unless terminated pursuant to the agreement, is still in effect. The asset manager's performance is included in periodic reports to the Board and the Growth Committee, and may be discussed from time to time as part of the Board and Growth Committee's responsibility to oversee LACERA's global public equity investments.

In addition to its current services, the asset manager, and other divisions within the same corporation, have expressed interest in doing other work for LACERA and may, from time to time, participate in responding to Requests for Proposals and other opportunities for new assignments in various asset categories. For example, this asset manager unsuccessfully bid on fixed income and private equity RFPs. Currently, the asset manager performs no services for LACERA other than under the IMA for non-U.S. emerging market public equities.

Trustee Sanchez and the Asset Manager

Beginning in or around May 2018, Trustee Sanchez began discussions with the asset manager and other divisions within the same corporation, concerning various forms of potential business transactions between them. Trustee Sanchez advised LACERA's Legal Office in or around early June 2018 because she was aware of the asset manager's relationship with LACERA. Since that time, Trustee Sanchez has continued to keep LACERA's Legal Office informed of the status of her discussions with the asset manager as they continued and evolved.

By mid-August 2018, the discussions between Trustee Sanchez and the asset manager had focused to the point where it now appears that the form of transaction could be, should it go forward, a consulting agreement between Chantico and the asset manager, with a scope of work including bespoke statistical modeling and market research in connection with a mutual fund unrelated to LACERA and managed by the asset manager. Although the fee arrangement is not yet

finalized, it appears likely at this time that, if a contract is signed, Chantico will be paid hourly for its consulting services.

Following the formation of Chantico in 2013, Trustee Sanchez and the asset manager had periodic discussions about potential business. However, the contract under discussion between Chantico and the asset manager, if it is finalized, will be the first actual business between those entities. Chantico and the asset manager did not have a client or contractual relationship at any time during the five years preceding Trustee Sanchez's appointment to the LACERA Board.

Trustee Sanchez's Recusal

Upon being informed by Trustee Sanchez of the discussions with the asset manager, LACERA's Legal Office evaluated the matter and advised Trustee Sanchez that, out of an abundance of caution, she should recuse herself and leave the boardroom during consideration of any item that relates to or could have an effect upon the asset manager or its corporate family so long as the discussions with the asset manager continued. The Legal Office further advised Trustee Sanchez and other LACERA officials that the Board should not, pending additional information as to the potential conflicts issue, amend the existing contract or enter into any new contracts, with the asset manager or its corporate family.

ANALYSIS

Section 1090

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.)

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.) When an officer with a proscribed financial interest is a member of the governing body of a public entity, the prohibition of Section 1090 extends to the entire body. (89 Ops.Cal.Atty.Gen. 49, 50 (2006); *Fraser-Yamor Agency, Inc. v. County of Del Norte* (1977) 68 Cal.App.3d 201, 211-212.)

New Contract Between LACERO and the Asset Manager

You have asked whether Section 1090 would prohibit the Board, with participation by Trustee Sanchez, from entering a new contract with the asset manager to perform different services than it provides now if Trustee Sanchez's company enters into a consulting agreement with the asset manager for services unrelated to LACERO. The determinative issue is whether Trustee Sanchez would have a financial interest in the new contract. We conclude that she would.

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), and officials are deemed to have a financial interest in a contract if they might profit from it in any way. (*Ibid.*) Although Section 1090 nowhere specifically defines 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. (See e.g., *Thomson v. Call, supra*, 38 Cal.3d at pp. 645, 651-652; 85 Ops.Cal.Atty.Gen. 34, 36-38 (2002).)

In addition, case law and statutory exceptions to Section 1090 make clear that the term “financially interested” must be liberally interpreted. (See, e.g., *People v. Deysher* (1934) 2 Cal.2d 141, 146 [“(h)owever devious and winding the chain may be which connects the officer with the forbidden contract, if it can be followed and the connection made, the contract is void”].) Further, “the certainty of financial gain is not necessary to create a conflict of interest ... (t)he government's right to the absolute, undivided allegiance of a public officer is diminished as effectively where the officer acts with a hope of personal financial gain as where he acts with certainty.” (*People v. Gnass* (2002) 101 Cal.App.4th 1271, 1298 (citations omitted).)

Instructive here is a 2003 California Attorney General opinion where the board of a redevelopment agency anticipated entering into contracts with business firms intending to locate or expand their offices in a certain redevelopment project area. (86 Ops.Cal.Atty.Gen. 187 (2003).) Several of those businesses were clients of one of the board member’s promotional products company. (*Ibid.*) In determining that the board member would have a financial interest in any contracts between the redevelopment agency and those businesses, the opinion stated:

The board member would have a “financial interest” in the contracts due to his business relationship with the contracting parties as a supplier of goods or services. (See 85 Ops.Cal.Atty.Gen. 176, 177-179 (2002); 85 Ops.Cal.Atty.Gen. 34, 35-37 (2002).) In this regard, the board member could be influenced by the prospect of future business opportunities directly related to the contracts or by a desire to maintain favorable ongoing relationships with the contracting parties. The Legislature has made clear that ongoing business relationships may represent financial interests for purposes of section 1090. (See, e.g., § 1091, subd. (b)(5), (b)(6), (b)(8).) The purpose of section 1090 “is to remove or limit the possibility of any personal influence, either directly or indirectly, which might bear upon an official’s decision” (Citations omitted.)

(86 Ops.Cal.Atty.Gen. at p. 188.)

The present matter is similar. If Trustee Sanchez entered a consulting services contract with the asset manager, she would have a financial interest in any new contract between LACERO and the asset manager based on her business relationship with the asset manager as a supplier of services. She could be influenced in her decisionmaking by the possibility of future business opportunities and/or the desire to maintain a favorable relationship with the asset manager.

The conclusion that Trustee Sanchez would have a financial interest in any new contract between LACERO and the asset manager is underscored by looking to the statutory exceptions to Section 1090. As noted above, the Legislature has made clear that ongoing business relationships, including those for the provision of goods and services, represent financial interests for purposes of Section 1090. Under Section 1091(b)(8), however, an official has only a remote interest in a contract entered into by the body or board of which they are a member if they are a “supplier of goods or services when those goods or services have been supplied to the contracting party by the officer for at least five years prior to his or her election or appointment to office.”

Thus, Trustee Sanchez would have a prohibitory financial interest under Section 1090 in any new contract between LACERA and the asset manager if she provides services to the asset manager, but only a remote interest if those services were provided for at least five years prior to her appointment to the LACERA Board in 2018. According to the facts, although Trustee Sanchez has engaged in periodic discussions with the asset manager about providing consulting services, she has never actually provided such services to the asset manager. In fact, you state that if the proposed contract between Chantico and the asset manager is finalized, it will be the first actual business between those entities. Therefore, no exceptions to Section 1090 apply to allow a contract between Trustee Sanchez’s business and the asset manager.

You suggest Trustee Sanchez may not be financially interested in any new contracts between LACERA and the asset manager pursuant to *Eden Township Healthcare Dist. v. Sutter Health* (2011) 202 Cal.App.4th 208. There, a district official participated in negotiating public contracts with a nonprofit corporation that employed the official as its president and chief executive officer. (*Id.* at pp. 212-214.) The official had no ownership interest in the nonprofit corporation. (*Ibid.*) The *Eden* court found that the official was not financially interested in those contracts because there was no evidence to suggest that the official’s compensation would in any way be impacted by those contracts. (*Id.* at p. 227.)

Eden is factually different than the present matter, and we do not view its holding so broad as to cover the facts of this situation. Trustee Sanchez is the founder, Chief Executive Officer, and 75% shareholder of Chantico, a for-profit consulting firm; she is not a salaried employee of a nonprofit organization. Nonetheless, you assert the hourly compensation her company will receive from the asset manager will not be affected by, and she will receive no other personal benefit under, the new contract between LACERA and the asset manager. Even if true, this point is not persuasive, especially when considering her company could be looking for future business opportunities with the asset manager.

As mentioned above, the underlying purpose of Section 1090 is to “remove or limit the possibility of any personal influence, either directly or indirectly, which might bear upon an official’s decision . . .” (See, e.g., *Stigall*, supra, at p. 659.) In addition, “[t]he defining characteristic of a prohibited financial interest is whether it has the potential to divide an official’s loyalties and compromise the undivided representation of the public interests the official is charged with protecting.” (*Lexin v. Superior Court* (2010) 47 Cal.4th 1050, 1075.)

If Trustee Sanchez's business were to enter a contract with the asset manager, it is difficult to imagine, for reasons mentioned above, how she would ever be able to provide her absolute, undivided allegiance to LACERA when participating in the contracting process involving a client of her firm. This real potential to divide her loyalties is precisely the type of situation Section 1090 seeks to prevent.

Accordingly, if Trustee Sanchez's consulting business were to enter a contract with the asset manager, Section 1090 would prohibit her from participating in any new contracts between LACERA and the asset manager.² And when Section 1090 is applicable to one member of a governing body of a public entity, the prohibition cannot be avoided by having the interested board member abstain; the entire governing body is precluded from entering into the contract. Also, please note that a decision to modify, extend, or renegotiate a contract constitutes involvement in the making of a contract under section 1090. (See *City of Imperial Beach v. Bailey* (1980)103 Cal.App.3d 191.)

Conflicts Under the Act

Section 87100 prohibits any public official from making, participating in making, or otherwise using his or her official position to influence a governmental decision in which the official has a financial interest. A public official has a "financial interest" in a governmental decision, within the meaning of the Act, if it is reasonably foreseeable that the decision will have a material financial effect on one or more of the public official's interests. (Section 87103; Regulation 18700(a).) Relevant to the facts provided, Section 87103 identifies interests from which a conflict of interest may arise, including:

- An interest in a business entity in which the official has a direct or indirect investment of \$2,000 or more (Section 87103(a)); or in which the official is a director, officer, partner, trustee, employee, or holds any position of management (Section 87103(d)).
- An interest in a source of income to the official, including promised income, which aggregates to \$500 or more within 12 months prior to the decision. (Section 87103(c).)
- An interest in his or her personal finances and those of immediate family members. (See Section 87103.) An official always has an interest in his or her personal finances.

Here, Trustee Sanchez has an interest in her consulting business as a business entity and source of income, an interest in any clients of the business from whom she has received income aggregating \$500 or more in the previous 12 months as sources of income, and an interest in her personal finances.³

² In response to the inquiry in your request, this prohibition would apply to decisions on contracts related to other divisions or entities from within the same corporation as the asset manager. However, it would not apply to contracts with other LACERA managers in the same asset category but not part of the asset manager's larger corporate family. Also note that we do not further analyze this issue under the Act.

³ An effect on an official's interest in his or her personal finances or those of immediate family members is not considered separately if the decision also affects the official's interest in a business entity or real property

Foreseeability and Materiality

Regulation 18701(a) provides that a financial effect on an official's financial interest is presumed to be reasonably foreseeable if the interest is a named party in or the subject of a governmental decision before the official's agency.

You have asked whether Trustee Sanchez could continue to provide monitoring and oversight of the current contract between LACERA and the asset manager if her consulting business were to enter a contract with the asset manager. To the extent monitoring and oversight involves governmental decisions, the asset manager would presumably be the named party in and/or the subject of such decisions, and the financial effect on her interest in the asset manager will be presumed to be reasonably foreseeable.

Regulation 18702.1(a)(7)⁴ provides that a decision's reasonably foreseeable financial effect on a business entity in which an official has an interest is material whenever the business entity is "subject to an action taken by the official's agency, the effect of which is directed solely at the business entity in which the official has an interest."

Thus, the Act prohibits Trustee Sanchez from taking part in any governmental decisions involving monitoring or oversight of the contract between LACERA and the asset manager because the decisions would be directed solely at the asset manager and would have a reasonably foreseeable material financial effect on the asset manager.⁵

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

Sincerely,

Dave Bainbridge
General Counsel

By: 
Jack Woodside
Senior Counsel, Legal Division

JW:jgl

(Regulation 18702.5(c)). Because the decisions at issue also affect the Trustee's business interest, we do not further analyze her personal financial interests.

⁴ Regulation 18702.1 sets forth the materiality standards applicable to an interest in a business entity explicitly involved in a decision, including a source of income. (Regulation 18702.3(a)(4).)

⁵ Because we have already determined that the Act prohibits the Trustee Sanchez from taking part in the decisions at issue, we do not further analyze her other financial interests implicated by those decisions.