



Section 1090 Update: *Davis v. Fresno*, FPPC Opinions and Other Developments

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Sean SeLegue, Partner, Arnold & Porter

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SECTION 1090 UPDATE: DAVIS V. FRESNO, FPPC OPINIONS AND OTHER DEVELOPMENTS

By [Sean M. SeLegue](#)

Arnold & Porter
San Francisco

INTRODUCTION

This paper provides an update on certain applications of Government Code Section 1090. First, it examines the long-running case of *Davis v. Fresno Unified School District*, which is currently at the California Supreme Court to decide whether a lease-leaseback school construction contract is subject to validation. This paper first addresses the ruling in an earlier phase of *Davis* (*Davis I*) related to Section 1090, before briefly summarizing the issue on review, which is not related to Section 1090. The Section 1090 discussion in *Davis I* addresses situations in which a contractor performs services for a public entity that could make the contractor subject to Section 1090 when the contractor enters into a subsequent contract with the entity. Subsequent court decisions and Fair Political Practice Commission (“FPPC”) letter opinions have provided further guidance in this area. Second, we have a look at authorities interpreting Section 1090 in connection with situations in which a board member owns real property that could be affected by a public entity’s action or in which the entity is in litigation with the board member. That discussion includes consideration of the “rule of necessity,” which—according to the FPPC—can apply “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.

OVERVIEW OF SECTION 1090

The Fair Political Practices Commission recently summarized Government Code Section 1090 as follows:

Section 1090 generally prohibits public officers or employees, 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 a public officer or employee from exercising absolute loyalty and undivided allegiance in furthering the best interests of their agencies. *Stigall v. City of 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 646-49. Importantly, Section 1090 prohibits the use of a public position for self-dealing. See *Hub City Solid Waste Services, Inc. v. City of Compton* (2010) 186 Cal.App.4th 1114, 1124 (independent contractor leveraged his public position for access to city officials and influenced them for his pecuniary benefit); *California Housing Finance Agency v. Hanover* (2007) 148 Cal.App.4th 682, 690 (“Section 1090 places responsibility for acts of self-dealing on the public servant where he or she exercises sufficient control over the public entity, i.e., where the agent is in a position to contract in his or her official capacity”); *Lexin*

v. Superior Court (2010) 47 Cal.4th 1050, 1090 (The purpose of Section 1090 is to prohibit self-dealing, not representation of the interests of others).¹

Violation of Section 1090 is a serious matter. As noted already, violating Section 1090 can render a contract void. That rule can apply even if a member of a governing body does not participate in a decision because board members are generally presumed to have participated in the body's decision. This means that in certain instances a public entity can be completely prohibited from entering into certain contracts based on a board member's interests. In addition, violation of Section 1090 can be a crime and does result in prosecutions.

DAVIS v. FRESNO UNIFIED SCHOOL DISTRICT (*Davis I*)

Implications of a contractor participating in the entity's consideration of a future contract. *Davis v. Fresno Unified School Dist.* (2015) 237 Cal.App.4th 261 ("*Davis I*") considered a situation in which a contractor entered into a "preconstruction" agreement with a school district. That work involved "development of plans, specifications and other construction documents for the project." *Id.* at 295. The plaintiff alleged that a subsequent contract in which the contractor agreed to actually build the school that was the subject of the preconstruction work violated Section 1090. The preconstruction work made the contractor an officer or employee of the district for purposes of Section 1090.

According to the plaintiff's allegations (which had to be assumed true because this case was on demurrer), the contractor "had a hand in designing and developing plans and specifications by which the project is being constructed." The issue *Davis I* considered was whether a corporate contractor could be considered an "officer" or "employee" of the district and therefore subject to Section 1090. *Davis I* concluded that the term "employee" in Section 1090 could encompass a corporate contractor, regardless of whether the contractor would qualify as an employee in the usual sense of that word. *Id.* at 300.

Subsequently the California Supreme Court took up the same issue in *People v. Superior Court (Sahlolbei)* 3 Cal.5th 230 (2017). The court agreed with *Davis I* "that the Legislature did not intend to categorically exclude independent contractors from the scope of section 1090." *Id.* at 238. It concluded that "due to the prophylactic purpose of conflicts statutes, . . . section 1090 should be constructed broadly to ensure that the public has the official's 'absolute loyalty and undivided allegiance.'" *Id.* at 239 (quoting *Stigall v. City of Taft* (1962) 58 Cal.2d 565, 569). "The focus is on the substance, not the form, of the challenged transaction, disregarding the technical relationships of the parties and looking behind the veil which enshrouds their activities." *Id.* (internal quotation marks omitted). However, the Supreme Court clarified that "not . . . all independent contractors are covered by Section 1090." *Id.* at 240 (emphasis omitted). Only those who "have been entrusted with transacting on behalf of the Government" fall within the statute. *Id.*

The Court of Appeal in *California Taxpayers Action Network v. Taber Constr., Inc.* (2019) 42 Cal.App.5th 824 explored this test in connection with a school preconstruction contract similar to that at issue in *Davis I*. The court held that the contractor providing the preconstruction services was not covered by Section 1090 as a result of that agreement because the contractor was not "hired to engage in or advise on public contracting *on behalf of the School District.*" *Id.* at 836 (emphasis in original); *id.* (contractor provided "construction services *to the School District, not in a capacity as a de facto official of the School District*) (emphasis in original). In addition, the contractor could not have been said to have used its role in the preconstruction services to facilitate being chosen as the actual construction contractor because—when hired for the preconstruction phase—the contractor "was already selected for the whole project." *Id.* at 835 (internal quotation marks omitted). In other words, the purpose of the preconstruction work was not to select the contractor but to prepare for construction by the already selected contractor.

¹ This overview of Section 1090 to this point is verbatim from FPPC Letter Opinion A-22-064 (Aug. 23, 2022).

Importantly, the court in *Taber* viewed the existence of two contracts—one for preconstruction and the second for construction—as substantially similar to contractual clauses that allow an “out” for one reason or another. *Id.* at 832.

The FPPC has issued numerous letter opinions on the subject of “whether a public entity that has entered a contract with an independent contractor to perform one phase of a project may enter a second contract with the same independent contractor for a second phase of the same project.” FPPC Letter Opinion A-21-122 (Oct. 11, 2021). It applies a two-part test as follows:

The first issue is whether the independent contractor had responsibilities for public contracting on behalf of the public entity under the initial contract. If not, then the independent contractor is not subject to Section 1090 and the public entity may enter the subsequent contract. If so, then the second question is whether the independent contractor participated in making the subsequent contract for purposes of Section 1090 through its performance of the initial contract. If not, then the public entity may enter the subsequent contract. If so, then Section 1090 would prohibit the public entity from entering the subsequent contract.

Id. The FPPC has found numerous situations in which a single contractor that has provided services on one aspect of a project is not precluded from providing services on a subsequent phase of the project.

For example, in FPPC Letter Opinion A-20-059 (June 2, 2020), a joint powers authority engaged an engineering firm for a five-year term to provide conceptual level engineering work for a Sacramento-San Joaquin Delta water conveyance facility known as “WaterFix.” The authority wished to confirm the firm could provide engineering management services for projects identified for public competitive procurement, so long as the firm had “not served as the primary final designer” for that particular project. The FPPC agreed the firm could provide those services because (1) neither the engineering firm nor its subcontractors had authority or duties to contract on behalf of the authority and (2) oversight of the first phase of the firm’s work was provided by the authority’s executive director and board of directors, plus a chief engineer the authority had engaged.

In some later opinions the FPPC introduced additional factors for consideration. In FPPC Letter Opinion A-20-033 (May 13, 2020), the FPPC considered the nature of the project in approving a contractor’s work on a second phase. There, an architectural firm provided conceptual design services and renderings regarding the restoration of a historic building. The documents the firm provided would be incorporated in a subsequent RFP for the design-build phase. The FPPC approved the firm’s possible work in the design-build phase because the firm did “not really have much influence over [the] scope of work,” which was controlled by the city. The FPPC also noted that the firm “did not have the opportunity to influence the subsequent contract” because, as a restoration project, “there is very limited leeway in the design.” The design is “fairly set and straightforward, because it is intended to replicate and restore the original 1915 design.” As a result of these circumstances, the firm “was not in a position to leverage influence over the scope of the proposed subsequent contract for its own pecuniary benefit.”

In Letter Opinion A-19-004, the FPPC considered as a factor whether the contractor had an “unfair advantage” in obtaining the second contract as a result of performing the first. An engineering firm provided 30% design drawings that were incorporated into a subsequent RFP. Nothing that the city “maintained control” over the preliminary plans, the FPPC concluded that the firm’s work did not give it an “unfair advantage” in seeking work on the final design phase. The FPPC distinguished an earlier situation in which it had concluded Section 1090 barred a contractor which had designed a golf course from bidding on the construction contract. There, the “contractor had advised the city, worked closely with city staff and the project manager, and ultimately designed and developed the plan that later became the RFP, which was specific on exactly how the project was to be completed.”

Whether work is structured as one or more contracts can also be important. Recall that in *Taber* the Court of Appeal viewed two contracts as essentially one because the school district there intended from the beginning to

use the same company to provide both preconstruction and construction services. In FPPC Letter Opinion A-20-143 (Dec. 18, 2020), the FPPC concluded that an arrangement could not be structured as two contracts but it could have been established in a single contract. There, a city proposed to hire a company to develop an energy efficiency program and then to install items that the city approved in its “sole authority to include or exclude any of the specific options.” The contract would have to be amended at the end of the first phase to reflect the city’s choices. The FPPC noted that a contract amendment is considered a contract subject to Section 1090. Because “the scope of work in the subsequent amended contract would be established through services performed under the initial contract,” Section 1090 would bar the amended contract.

The manner in which a contractor is compensated for services can also be significant. In FPPC Letter Opinion A-21-021 (May 5, 2021), the FPPC approved a contract in which an outside contractor would act as a project manager, overseen by the city manager and community development director. The contractor would be paid hourly, subject to a cap. The fact that the contractor’s advice on project scope could increase his paid hours did not mean the contract—a single contract—violated Section 1090. The FPPC mentioned that “there is no indication of self-dealing” because of the hourly cap, oversight by city officials and a requirement that final decisions be approved by city staff or the city council; it is unclear if these facts were requirements for FPPC approval or just the proverbial “icing on the cake.” The FPPC distinguished a situation in which a contract city attorney’s compensation for bond counsel work was to be determined based on a percentage of the city bond’s issuances. That would impermissibly give the contract city attorney a financial interest in the size of the bond issuances.

Pending Supreme Court case (*Davis II*). Once again, the topic of the lease-leaseback method of school construction contracting has resulted in conflicting Court of Appeal decisions, this time leading to a grant of review by the California Supreme Court. In a lease-leaseback, a school district leases its land to a contractor for a nominal amount (the “lease”), and the contractor sub-leases the site back to the district (the “leaseback”). The contractor then builds a school and, when the term of the lease to the contractor concludes, title returns to the school district. Under Education Code Section 17406, lease-leaseback contracts are exempt from competitive bidding.

In *Davis II*, the Court of Appeal considered whether the lease-leaseback was subject to validation. The court first noted its ruling in *Davis I* that the lease-leaseback did not have a financing component because the governing documents were “ordinary construction contracts with progress payments (not true leases) that did not provide Fresno Unified with any financing—that is, the contracts did not spread Fresno Unified’s obligation to pay for the new construction over a significant amount of time.” *Id.* at 941. Accordingly, the court in *Davis II* concluded the fact that funds for the school project came from bonds was not enough to mean the lease-leaseback was “directly related” to the school district’s bonds. *Id.* Therefore, *Davis II* held that the lease-leaseback was not subject to validation.

The Supreme Court has limited its review of *Davis II* to the following question: “Is a lease-leaseback arrangement in which construction is financed through bond proceeds, rather than by or through the builder, a ‘contract’ within the meaning of Government Code section 53511?” In their merits briefing, the contractor and Fresno Unified also ask the court to consider the question decided in the earlier set of Court of Appeal cases: Are lease-leaseback contracts exempt from competitive bidding under Education Code Section 17406?²

² In addition to *Davis I*, the same issue was presented and decided in *McGee v. Torrance Unified School Dist.* (2016) 247 Cal.App.4th 235, 242 (“*McGee II*”) and *California Taxpayers Action Network v. Taber Construction, Inc.* (2017) 12 Cal.App.5th 115, 129-130.

The case is fully briefed and awaiting argument. Among the many *amici curiae* briefs filed is one from the League of California Cities, joined by the California Special Districts Association.³

SECTION 1090: DEALINGS WITH BOARD/COUNCIL MEMBERS

Two recurring issues are what restrictions Section 1090 imposes when a board member (1) owns real property that could be affected by the public body's actions or (2) is a party to litigation with the public entity that board member serves.

Real Property: overall framework. In *Thomson v. Call* (1985) 38 Cal.3d 633, a developer wanted to transform its 36-acre parcel into a 2,500-unit residential complex. As part of a deal with the City of Albany, the developer agreed to spend \$600,000 to create a park. The developer arranged a plan to buy three parcels adjacent to the developer's land for that purpose. Call, a member of the city council, owned one of the parcels. Call agreed to sell his parcel to the developer for \$258,000, knowing about the developer's plan. In a frequently cited holding, the Supreme Court held that the sale constituted an indirect transaction between Call and the city that used the developer "as a conduit." *Id.* at 650 n.25.

The court in *Call* "recognized the difficulty faced by a public officer who—for reasons beyond his control—finds himself in a potential conflict-of-interest situation." *Ibid.* The court identified three solutions for the official: (a) resign from office; (b) divest the property interest causing the conflict or (c) abstain from the transaction and allow the city to acquire the parcel through eminent domain if the city wished to do so. The court did not view resignation as "a viable alternative" because that course of action "may be counter to the public interest in retaining competent public officers." *Ibid.*; see also *Eldridge v. Sierra View Local Hosp. Dist.* (1990) 224 Cal.App.3d 311 (1990) (hospital district could not prohibit employee from taking office as elected board member). That leaves the only options for the public entity as (1) foregoing the transaction or (2) litigating an eminent domain case to take the board member's property.

Litigation with board members. Even if an eminent domain action is pursued against a board member, Section 1090 issues remain, as is the case any time an entity faces litigation with a board member. The decision in *Santa Clara Valley Water District v. Gross* (1988) 200 Cal.App.3d is instructive. There, the court considered issues that arise when a public agency exercises eminent domain over a property owned by a member of its governing board. A water district had condemned a parcel owned by one of its directors, Gross, and his wife. Under Section 1250.410(a) of the Code of Civil Procedure, both sides were required 30 days prior to trial to state either a final offer of, or final demand for, compensation.⁴ If, after entry of judgment, the court finds *both* that the defendant's offer was reasonable *and* that the plaintiff's offer was *unreasonable*, the defendant is entitled to recover litigation expenses.

In *Gross*, both plaintiff and defendants thought Section 1090 prohibited them from participating in the statutory procedure. After judgment, the Grosses nonetheless sought to recover litigation expenses (such as attorney's and expert witness fees) under Section 1250.410(a). The Court of Appeal held they were not entitled to such recovery because defendants had not followed the statutory procedure. The court saw no impediment arising from Section 1090 to the Grosses participating in the offer/demand exchange process, reasoning as follows:

Once a condemnation action has been filed, . . . the property owner and his agency become adversaries, subject to the rules of court and civil procedure which govern the course of litigation. A settlement achieved pursuant to these rules can be supervised by the court and receive the imprimatur of court confirmation. Government Code section 1090 is directed at dishonest conduct and at conduct that tempts dishonor; it has no force in the context of a

³ The author formerly represented the contractor in *Davis*. This paper expresses only the author's views and not the contractor's.

⁴ The statutory period is now 20 days.

condemnation action where the sale of property is accomplished by operation of law and each side is ordinarily represented by counsel.

Id. at 1369 (citation and internal quotation marks omitted). The court also noted that the Grosses' position was not entirely consistent. They asserted that they had not abided by the statutory valuation procedure out of concern for complying with Section 1090, but at the same time they had participated in two settlement conferences, a fact they emphasized on appeal apparently to show that their behavior was not in bad faith. *Ibid.*

Notably, *Gross* did not approve the board member's participation in settlement conferences across the table from the entity he served as a board member. *Gross's* holding is limited to approval of an agency and board member participating in the procedure that Section 1250.410(a) mandates for exchange of a demand and offer related to valuation in an eminent domain action. Can an agency and one of its board members pursue other means of resolving a dispute between them?

Attorney General Opinion 03-408 provides an answer. There, the Attorney General concluded that a community service district could not enter into a settlement agreement with one of its directors concerning the director's action against the district challenging a neighbor's permit. "We reject any suggestion that the execution of a settlement agreement might be permitted under the holding of *Santa Clara Valley Water Dist.*" *Id.* at 5. In the Attorney General's view, *Santa Clara Valley Water Dist.* recognized a "narrow exception" that "was based upon a special statute establishing a formal, court-supervised framework for exchanging final offers and demands in a condemnation action." *Id.*

In Attorney General Opinion 07-104, the Attorney General offered a more expansive discussion of the same issues, reaching the same conclusion but providing more guidance. The context for this opinion was a civil rights action filed by a resident against a city and certain of its employees as well as county employees. The plaintiff was later elected to the city council. The opinion concludes that Section 1090 would not permit the plaintiff and the city to enter into a settlement agreement because such an agreement is a contract within Section 1090's reach. However, the opinion concluded that *negotiations* are not prohibited.

The opinion identified two situations in which an official could negotiate with the entity he serves. First, the parties may comply with a court's directive to attend and participate in a mandatory settlement conference because the court lacks the power to force the parties to enter into a settlement agreement. Second, the opinion stated that a settlement between the plaintiff and the individual defendants (not the entity for whom the plaintiff served as a board member) would be outside the scope of Section 1090.

However, the Attorney General opinion's green light for negotiations may face some headwinds under *Stigall*. There, a city council member's plumbing company bid on a city contract. The council member resigned before formal approval of the contract, but that did not save the contract from being invalidated under Section 1090. That is because the council member was deemed to have participated in the contract preparations prior to resigning. If that were not the case, the Supreme Court explained, a "council member could participate in all negotiations giving a contract its substance and meaning, be instrumental in establishing specifications and schedules most advantageous to his or his firm's particular mode of operation, participate in the selection of his or his firm's offer, resign just prior to formal acceptance of that offer and execute the contract as the other party thereto." 58 Cal.2d at 570.

Rule of Necessity. In a series of Letter Opinions beginning in 2016, the FPPC identified a number of situations in which the "rule of necessity" would permit a public entity to enter into a transaction that Section 1090 would otherwise prohibit.

In FPPC Letter Opinion A-16-80 (Dec. 2, 2016), a water district board member owned land adjacent to two district facilities, a wastewater treatment plant and a tank, both of which were landlocked. The district and the board member had a complicated dispute about access routes. Without citing or discussing any of the judicial or Attorney General authorities discussed above, the FPPC concluded that the rule of necessity allowed the district

and the board member to resolve their dispute by agreement so long as the board member abstained from involvement in that process in his individual capacity.

The FPPC reasoned that the rule of necessity had been applied in the past “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.” *Id.* at 4. For its conclusion, the FPPC relied on *Eldridge v. Sierra View Hosp. Dist.* (1990) 224 Cal.App.3d 311, which held that an employee of a hospital district was not prohibited from sitting on that agency’s board.

Recently, in 2021, the FPPC applied similar reasoning to a situation in which a city needed to extend a four-lane highway for about a mile to accommodate a large volume of traffic. The city’s Mayor Pro Tem owned a significant amount of land—more than 7 acres—that would be affected by the project. The project had been planned for a long time—*i.e.* was long delayed—and “careful[] study” failed to produce a feasible alternative alignment. Under these circumstances, the FPPC concluded the rule of necessity permitted the city to proceed with project so long as the Mayor Pro Tem did not participate in relevant decisions. See FPPC Letter Opinion A-21-112/113 (Aug. 27, 2021).

FPPC Letter Opinion A-18-112 (June 29, 2018) considered a situation in which a community service district board member owned a piece of property that enjoyed a restrictive covenant on district property across the street. A local historical society proposed that a historic schoolhouse be moved to the district’s property in violation of the restrictive covenant. The FPPC concluded that Section 1090 would ordinarily prohibit the district from entering into a contract with the board member to modify the restrictive covenant because the board member would be conclusively presumed to have participated in the decision. Among other things, the FPPC noted that the market value of the board member’s property could be affected by the proposed deal, which meant Section 1090 would ordinarily bar the district from entering into the proposed contract.

The FPPC concluded that the rule of necessity permitted the district to enter into the proposed contract with the board member. One of the district’s core duties was to provide community services, which included providing a place for the historic structure. Because the board member was the only person who could amend the covenant, the FPPC concluded the rule of necessity applied.

There are, however, limits to when the rule of necessity may properly be invoked. In FPPC Letter Opinion A-19-232 (Feb. 27, 2020), a town wished to transfer a small, unusable piece of real property to the four adjoining landowners. The property, which had been designated as a right of way but was never used for that purpose, offered no value to the city, but it did present the potential for liability. It could not be developed because a creek ran through the parcel, comprising most of its square footage. In short, the city would be better off without this land.

A problem arose because a council member owned one of the four adjoining parcels. The town attorney asked the FPPC if an arrangement could be put in place whereby the property would be divided in four, after which three of the resulting parcels would be transferred immediately to the other three landowners. Transfer of the fourth parcel to the council member would be deferred until he left office.

The FPPC concluded that Section 1090 would not permit this plan to be implemented. While the Town Manager had authority to sign the necessary deeds without action by the council, the power for him to do so had been delegated by the council. As a result, the council was deemed to participate in the transaction even if the Town Manager undertook it on his own initiative, and the affected council member would be deemed to be a participant on the city’s behalf. The FPPC concluded that no part of the proposed arrangement could be put in until the council member/land owner left office.

The FPPC did not discuss the rule of necessity in this opinion. It seems fair to assume that because the parcel was small, the transaction could not rise to a level of public importance sufficient to invoke that rule.

Real Estate Transactions That Fall Outside Section 1090. Three FPPC Letter Opinions describe nuanced situations in which Section 1090 would not prohibit a transaction between a public entity and one of its board members.

FPPC Letter Opinion A-18-070 (June 8, 2018) considered whether a business of which a city council member was an owner could bid on property being sold by a receiver at auction. The sale resulted from a nuisance action the city filed against a private property owner. The city would not be a party to the sale but could participate by filing a brief in the court proceedings related to the sale. Because the city would not be a party to the transaction, it was permissible for the council member's business to bid so long as he recused himself from any decisions at the city regarding the matter.

In FPPC Letter Opinion A-18-126 (Aug. 24, 2018), a city council member owned an interest in an LLC that owned vacant land. The LLC wished to subdivide the land and, to do so, would have to dedicate a five-foot-wide strip of land to the city to permit creation of a roadway that would meet a width requirement imposed by the city's General Plan. The council would have to approve any such agreement.

The subdivision itself was subject to the statutory "remote interest" exception to Section 1090 and therefore that step presented no Section 1090 problem. However, the proposed agreement by which the LLC would dedicate some of its land for a roadway remained as an issue: was the right-of-way dedication agreement also subject to the Section 1090 exception for subdivisions? Concluding that the dedication agreement was "part of the subdivision of lands," the FPPC concluded the agreement was exempt. Consequently, the city could enter into the agreement so long as the council member refrained from participating in his official capacity.

Finally, FPPC Letter Opinion A-17-272 (Mar. 20, 2017), concluded Section 1090 did not come into play regarding a council member's proposed donation of land to the city. The only effect of the transaction that the FPPC perceived was that the council member would receive a tax deduction. That, the FPPC opined, did not constitute a contract between the council member and the city. However, the opinion notes that the donation was intended to build "a new fire station on a new signalized corner." The opinion does not discuss whether the proposed donation included a legally enforceable restriction on the property's use; if it did, then presumably the agreement between the council member and the city would present Section 1090 issues.

Author



[Sean M. SeLegue](#)

Partner
San Francisco

sean.selegue@arnoldporter.com

+1 415.471.3169