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MEMORANDUM-ANALYSIS

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Subject: Principal Investigator on Auxiliary Board

Issue

Does the financial interest prohibition in Education Code Section 89908(a) bar university faculty (e.g., as Principal Investigator) from having a financial interest in grants or other externally-sponsored projects administered by an auxiliary organization while serving on its governing board?

Analysis

The issue hinges on how the terms “contract,” “transaction” and the phrase “entered into by the board” used in Education Code Section 89906 are interpreted.

Except in certain circumstances, an auxiliary organization board member (director) must avoid *transactions* of the board in which the director has a financial interest.¹ The term includes *contracts* entered into by the governing body. To do so is “misconduct in office” and the “contract or other transaction” breaching this prohibition is void, unless it meets a two-element circumstance test:²

- Was the financial interest disclosed or known to the board and noted in the meeting minutes, followed by a favorable, good faith board vote sufficient for the action without including the interested director(s)?
- Is the contract or transaction just and reasonable as to the auxiliary *when authorized or approved?*

There are, however, several *circumstance-exceptions* to the application of the above test, any one of which **revives the prohibition**. They are if

- The contract or transaction is directly between the interested director(s) and the auxiliary.³

¹ *Cal Ed Code* § 89906.

² *Ibid* at § 89907.

³ *Ibid* at § 89908(a).

- The contract or transaction is between the auxiliary and a partnership or unincorporated association in which a director(s) holds an ownership, partnership or other proprietary interest.⁴
- The contract or transaction is between the auxiliary and a corporation in which the interested director(s) owns or directly or indirectly holds more than a five percent (5%) of the outstanding common stock.⁵
- The director(s) fails to disclose to the board the financial interest in the transaction at a public meeting, then influences or attempts to influence one or more board members in entering into the transaction.⁶

Does the Section 89908(a) prohibition apply to faculty serving on the governing board while a *Principal Investigator* of a grant or sponsored project obtained by the university and administered by the auxiliary organization?

First, the Section 89908(a) prohibition deals with contracts or transactions between the organization and the board member(s). Grant agreements or externally-sponsored project contracts are with the grantor or external sponsor organization – not with the faculty.

Further, the Section 89906 phrase “contract or other transaction” was not, in my view, intended by the Legislature to include employment relationships. Here’s why:

The statute originally enacting Section 89906 also contained Section 89006. That section provides that:

It is unlawful for any person to utilize any information, not a matter or public record, that is received by that person by reason of his or her employment by, or contractual relationship with, the trustees, the California State University, or an auxiliary organization of the California State University, for personal pecuniary gain, not contemplated by the terms of the employment or contract, regardless of whether the person is or is not employed or under contract at the time the gain is realized.

While Section 89906 uses the phrase “any contract or other transaction,” Section 89006 uses the phrase “employment by, or contractual relationship with.” If there had been an intention to include employment relationships in Section 89906, the phrasing could easily have read, for example, “any employment relationship, contract, or other transaction.” Use of the term “employment” in Section 89006 *and* its absence in Section 89906 is most reasonably interpreted as the end result of Legislative intent to *include* “employment relationships” in Section 89006 and to *exclude* them in Section 89906.

⁴ Ibid §89908(b).

⁵ Ibid § 89908(c).

⁶ Ibid § 89908(d).

Furthermore, the Section 89006 constitutes a self-dealing and conflict-of-interest standard for employees of auxiliary organizations that stands on its own, making unnecessarily redundant an interpretation that the Section 89906 “contracts and other transactions” extends to employment relationships.

There is a July 13, 1971 OGC opinion that the term “transaction” used in Section 89906 includes “the entering into of a relationship, not necessarily contractual, which would have legal significance.” The issue involved a campus AS president (ex-officio governing board member) and employed as a program director. And in a September 5, 1972 OGC opinion there is an extended discussion of what was perceived by the Office of Legislative Counsel as an “unfortunate defect” in 89906 “... since this (application to student officer stipends) is not the type of activity which the Bill was designed to curtail.”

The OGC has over the years apparently acquiesced to the view that employment relationships are not covered by the Section 89906 term “transactions.” For example, some student body organizations (also auxiliary organizations) consider payments to student officers as wages (creating an employment relationship), but there has never, to my knowledge, been a determination that these payments created a Section 89906 conflict of interest.

Thus, in my view, the § 89908(a) prohibition does not *per se* bar faculty from having a financial interest in a grant or externally-sponsored project administered by the auxiliary organization while serving on its governing board.

Note that the financial-interest standard framed in § 89906 deals specifically with a contract or other transactions “entered into by the governing board,” while the enumerated *circumstance* prohibitions in § 89908 are framed more broadly and do not specify contract or transaction board action. Prevalent board policy/practices delegate to management the authority to approve the relationships leading to a grant or contract for an externally-sponsored project or program.

There may well be matters coming to the board for action dealing with a grant or project involving a faculty board member. These circumstances call for both the faculty-director and the board to follow the process and standards in Sections 89907 and 89908.

Legal counsel should be consulted in all cases involving potential conflict of interest situations.