HK School Law Monthly Newsletter

Greetings!
Thank you for your interest in the HK School Law Monthly Newsletter. Our firm is growing, and we are now Hansberger & Klein, LLP. We look forward to hearing from you soon!

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VISIT US AT CSDC!

Come visit Hansberger & Klein, LLP at the upcoming Charter Schools Development Center's 2014 Charter Schools Leadership Update Conference!

WHERE: Hotel Irvine Jamboree Center

WHEN: November 3-4, 2014

LEARN MORE

IN THE NEWS

Second *Vergara*-Inspired Lawsuit Filed in New York

A second lawsuit challenging New York laws governing teacher tenure, layoffs, and dismissals was filed Monday . . .

New Calif. Law Restricts Full-Contact Youth-Football Practices

Gov. Jerry Brown signed a law last week that prohibits high school and middle school football coaches . . .

AVOIDING SELF-DEALING TRANSACTIONS AND POLITICAL REFORM ACT VIOLATIONS

Many charter school boards and administrators are sometimes puzzled by the dizzying variety of “conflict of interest” laws that may – or may not – apply to charter schools in

California. While we can't cover every detail here, this newsletter is a quick primer of the relevant conflict of interest laws that charter schools must consider.

VIOLATIONS OF THE PROHIBITION AGAINST "EXCESS BENEFIT" TRANSACTIONS (CAL. CORP. CODE AND INTERNAL REVENUE CODE)

Non-profit corporations that enter into "excess benefit" transactions can: a) incur tax liability for the transaction, and b) threaten the tax exempt status of the non-profit organization.

Treasury Regulation §53.4958-4 describes transactions that are considered to be excess benefit transactions. The regulation emphasizes that, if an organization has directly or indirectly conferred an economic benefit on a disqualified person that exceeds the value of what the organization received in return, an excess benefit transaction has occurred. Transactions involving compensation and property transfers are likely to be the most common excess benefits.

There are four categories of people and organizations that are deemed to have substantial influence such that they can enter into an excess benefit transaction:

• Voting members of the organization's governing body;

• Persons having the responsibilities of the president, chief executive officer, or chief operating officer (e.g., the ultimate responsibility for implementing the decisions of the governing body or for supervising the management, administration, or operation of the organization), regardless of the actual title of the person;

• Persons having the responsibilities of treasurer or chief financial officer of an organization (e.g., the ultimate responsibility for managing the organization's finances), regardless of the actual title of the person; and

• Persons with a material financial interest in a provider-sponsored organization in which a participating hospital is an applicable tax-exempt organization.

POSSIBLE PENALTIES

• The IRS can impose excise taxes on disqualified persons who obtain excessive benefits from the organization. The IRS may also impose excise taxes on any managers of these organizations who knowingly approve an abusive transaction.

• The IRS may also seek revocation of the organization's tax-exempt status.

SELF-DEALING TRANSACTIONS (CAL. CORP. CODE)

Strict sanctions are imposed on directors of public benefit and religious corporations who engage in self-dealing transactions involving the corporation the directors are serving. "Self-dealing transactions" are any transactions to which the corporation is a party and in which one or more of its directors has a material financial interest, unless the transaction:

• Is specifically excluded from coverage by statute; or
• Although otherwise covered by the prohibition, is approved or validated.

A director who has a material financial interest in a transaction involving the nonprofit public benefit or religious corporation is an "interested director." The prohibition on self-dealing transactions applies regardless of whether the director is compensated for services as a director.

SELF-DEALING TRANSACTIONS (GOVT. CODE 1090)

Many charter schools “opt in” to the requirements of Govt. Code 1090 as a condition of approval or renewal of a charter petition. Pursuant to Govt. Code 1090, “[m]embers of the Legislature, state, county, district, judicial district, and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members.” To avoid penalties pursuant to Govt. Code 1090, the officer must have only a “remote interest” in the contract and the contract must be disclosed, noted in the official records of the body and the officer must recuse him/herself from influencing or voting on the contract.

Where a contract is found to be in violation of Govt. Code 1092, the board may a) “avoid” the contract(s) within four years after the date of discovery of the violation.

General penalties are specified in Govt. Code 1097: “Every officer or person prohibited by the laws of this state from making or being interested in contracts, or from becoming a vendor or purchaser at sales, or from purchasing script, or other evidences of indebtedness, including any member of the governing board of a school district, who willfully violates any of the provisions of such laws, is punishable by a fine of not more than one thousand dollars ($1,000), or by imprisonment in the state prison, and is forever disqualified from holding any office in this state.”

Penalties pursuant to Govt. Code 1097 may be brought by the Commission (through administrative action or civil action) or by the District Attorney or Attorney General.

POLITICAL REFORM ACT

Many charter schools also “opt in” to the requirements of the Political Reform Act as a condition of approval or renewal of a charter petition, and many charter school’s also opt in to these requirements in the organization’s Bylaws.

The Political Reform Act (“PRA”) covers conflicts of interest in a manner that is similar to a section of a charter’s Bylaws (and to Govt. Code 1090 discussed above). Pursuant to the Political Reform Act, California Code of Regulations 18700(a): “No public official at any level of state or local government may make, participate in making or in any way use or attempt to use his/her official position to influence a governmental decision in which he/she knows or has reason to know he/she has a disqualifying conflict of interest. A public official has a conflict of interest if the decision will have a reasonably foreseeable material financial effect on one or more of his/her economic interests, unless the public official can establish either: (1) that the effect is indistinguishable from the effect on the public generally, or (2) a public official's participation is legally required.”

A generally accepted eight-part test is used to determine if a public official has violated the Political Reform Act’s conflict of interest prohibitions.

1.Is a public official involved?

2.Is the public official making, participating in making or using or attempting to use her official position to influence a governmental decision?

3.What is the public official’s economic interest in the contract?

4.Is the public official’s economic interest directly or indirectly involved?

5.What is the appropriate materiality standard?

6.Was it foreseeable that the materiality standard would be met as a result of the governmental decision?

7.Will the effect on the public official be distinguishable from its effect on the public generally?

8.Is the public official legally required to make or participate in making the decision?

Further, government officials subject to the Political Reform Act MUST disclose all real or perceived conflicts of interest on a “Form 700” annually. Disclosures must include community property income (50%) of a spouse, including a spouse’s salary of any kind.

REPORTING AND ENFORCEMENT

Enforcement of the Political Reform Act is usually conducted by the Fair Political Practices Commission, but County District Attorneys and the Attorney General’s office may supersede FPPC investigations when criminal conduct is alleged. A matter will be fully investigated when there is sufficient information to believe that a violation of the Act has occurred. Information regarding potential violations of the Act comes from citizen complaints, referrals from other governmental agencies, media reports, audit findings or may be identified internally.

When sufficient evidence exists to prove a violation of the Act, the Enforcement Division will bring a prosecution action to the Commission, or may issue a Warning Letter, depending upon the facts of the case and the public harm caused. If the evidence is insufficient to warrant prosecution, a case may be closed with an Advisory Letter or without violation. The FPPC may initiate its own proceedings/sanctions, refer a complaint to the DA, or initiate a civil lawsuit (usually to recover monies).

WHAT YOU SHOULD DO

Verify that your organization has the requisite conflict of interest policies/codes in place and that board members and administrators adhere to those policies/codes. If your organization has opted in to the requirements of Govt. Code 1090 and/or the Political Reform Act, we would recommend that your organization adopt the FPPC model conflict of interest code.

Beyond such policies/codes, remember to train your Board and administrators annually on the conflict of interest prohibitions applicable to your organization. Taking preemptive action is the best way to avoid serious fines or sanctions – or possibly the revocation of your tax-exempt status.

QUESTIONS?

As always, if you have questions about this newsletter or any other matter, please call us at any time for guidance.