

CONFIDENTIAL

September 25, 2013

[redacted]

Re: ADVISORY OPINION, Case No. 13041.A

I. Summary and Recommendations

You are a [City employee] in the City's [Department A]. On [redacted], you contacted our office and relayed the following: [redacted] the City's [Department B] [redacted], discovered that the City had made payments to [Co. 1] [redacted] through an indirect subcontract [Co. 1] has with [Co. 2]. [Department B] discovered that one of [Co. 1]'s owners was [the Subject of this advisory opinion], who was employed [as a City employee in] [Department C] at the time of payments. He left City employment [redacted].

You requested an opinion regarding whether work performed for the City pursuant to an *indirect subcontract* constitutes a contract, work or business with the City that could rise to a prohibited financial interest in City business ("FICB") in violation of the City's Governmental Ethics Ordinance's ("Ordinance") if the indirect subcontractor is owned in whole or in part by a City employee. You forwarded documents that your office compiled, including the following: [Co. 1]'s direct voucher payments from the City; a tally of the payments made under its [Co. 2] indirect subcontract, referred to as the "C-2" form; a synopsis of its certification and compliance history and timetable; its vendor profile, contract details, and schedule C-1; [the Subject's] resume and Statements of Financial Interests ("FIS") forms for 2010 and 2012; and, his individual statement of ownership.

Board staff carefully reviewed the documents you provided, then spoke with [Administrator 1] in [Department B] [redacted], for clarification on [Department B] procedures, obtained copies of [Co. 1]'s monthly invoices to [Co. 2] [redacted], and reviewed copies of [the Subject's] Statements FIS forms from 2006 to 2012 that this office maintains. The Board has not otherwise conducted an independent investigation into this matter, but has instead relied on the facts provided by your office, the monthly invoices, the information provided by [Department B], and [the Subject]'s FIS forms, as presented in this opinion, in reaching our determination and recommendation.

On the facts presented, and based on its case precedents, the Board has determined that: 1) an indirect subcontract of an M/WBE does indeed constitute a contract, work or business with the City for purposes of Ordinance §2-156-110; and 2) that [the Subject] violated this Ordinance provision in [the two years up until the date of his resignation]. As explained in this opinion, the Board also recommends that [Department A] [redacted] recuperate the amounts the City paid in excess of the \$2500¹ limit permitted for financial interests in City business during the relevant

¹ In this report, the BOE applied the provisions of the Ordinance in effect until Nov. 1, 2012, because the conduct addressed occurred prior to that date. *Financial Interest* included any interest entitling a person to receive more than \$2,500 per year. §2-156-010(l). Under the current provision, that amount was reduced to \$1,000 per year. *Id.*

years, and has assessed [the Subject] a fine of \$1,500, pursuant to §2-156-410(e), as explained below.

A statement of the facts and our analysis follows.

II. History and Facts

This opinion focuses on the period beginning [redacted] to the time of [the Subject]’s resignation from his City employment on [redacted].

As a preliminary matter, the definition of “financial interest” in effect at all relevant times discussed in this opinion provided for several exceptions, including “any interest of the spouse of an employee which interest is related to the spouse’s independent occupation, profession or employment.”² In interpreting the meaning of *independent occupation*, the Board has applied several factors, including: (1) whether the City employee had an ownership interest, (2) participated in the management and operation of the company, or (3) exercised legal and financial control over the company.³ If the City employee met any of these factors, then the Board has determined that the business was not the spouse’s *independent occupation*, and was attributable in its entirety to the City employee.

In all of the documentation our office reviewed, [the Subject] identified himself as an owner and employee of [Co. 1]; therefore, by admission, neither [Co. 1] nor its city contract qualifies under the spousal *independent business* exception of the Ordinance, as established through Board precedent.⁴ Since it is not his wife’s independent business, the Board ascribes to [the Subject] his wife’s entire ownership and business interest in [Co. 1].⁵

A. [The Subject]’s Employment History

[The Subject] began his City employment [redacted] and resigned from that position and his City employment effective [redacted]. During his City employment, he worked in that position first with [Department D], and then beginning in [redacted], with [Department C], [redacted].

In his resume, [the Subject] stated that he worked as a part-time [redacted] at [Co. 1] from 2003-present. His description of that position was to “Provide marketing strategies, troubleshoot, repair and provide preventative maintenance [redacted].” [Co. 1] is [redacted] incorporated with the Illinois Secretary of State’s office (“SOS”) in [redacted] 2003, which lists [the Subject’s wife] as [Co. 1]’s President and agent, and [the Subject] as its secretary. On the City’s “Individual Statement of Ownership form, Attachment 1,” which he submitted with an application for City

² See, §2-156-010 (l).

³ See, Board case nos., 91052.A, 95007.Q, 98017.A, and 06051.A.

⁴ See, Board case nos., 06051.A (business determined not be the wife’s *independent business*, although she was listed as the sole owner, because she knew nothing of the business and was dependent on her husband, the city employee, for the operation of the business. The Board ascribed the wife’s business interest to her City employee husband and found that he had a prohibited FICB); and, 98021.A (business determined to be the wife’s *independent business* because City employee transferred his interest to his wife and relinquished all control over the business). The *independent business, occupation, profession* of relatives is codified in Ordinance § 2-156-110.

⁵ *Id.*, Case no. 06051.A.

business in [redacted], and which you provided, he described his responsibilities and offices held as, “Vice-President of the Board of Directors, Director of Marketing and Equipment Maintenance for [Co. 1] [redacted] Services.” On this form he also wrote that he [redacted] was a [redacted]% owner, and received no salary. In describing his expertise and any management and control of the applicant firm, he wrote, “Started [the] company along with wife since its inception.” He listed his wife as [the Subject’s wife].

Staff also reviewed [the Subject]’s FIS⁶ forms from 2006 to 2012. Beginning in 2007, he included [Co. 1] in the question that asks “in [the previous year] did your ownership interest in any person conducting business in Chicago entitle you to receive more than \$2500, have a cost or present of \$5,000 or more, or representing more than a 10% interest in the person?” and listed his ownership interest in [Co. 1] as [redacted]. On his 2009 FIS form, he did not list his ownership percentage interest, but from 2010 to 2012, he listed it at [redacted]%.

The City certified [Co. 1] as a MBE in 2009. The company is now certified as a MBE, WBE (“M/WBE”), [redacted]⁷ business, and its current certifications are valid until [redacted]. All these certifications must be renewed annually.

According to the City’s vendor profiles, [Co. 1] has both *direct* and *indirect* subcontracts for [its] services. In a *direct* subcontract, a primary contractor enlists another company to provide services directly related to the subject matter of the prime contract and an *indirect* subcontract is for services not directly related to the subject matter of the primary contract. For example, a prime contract to provide posters issues requests for two subcontracts, one for printing services and the other to clean the workspace. The subcontract for printing services is a *direct* subcontract because it is related to the subject matter of posters (posters need to be printed). Whereas, the subcontract for cleaning services is an *indirect* subcontract because it is not related to the subject matter of providing posters, but is a necessary service to the primary contractor (workspace needs to be cleaned).

B. City’s Direct Contract Payment History to [Co. 1]

The City maintains a contract payment history for prime contractors and their direct subcontractors. [Co. 1] provided janitorial cleaning services in the office [redacted] twice per month, between [redacted], which the City paid through direct voucher. However, none of the totals in any of those years exceeded the \$2500 limit that would have constituted a prohibited FICB under the Ordinance in effect at the time; therefore, these payments are not at issue in this case.

Since there was no direct payment history or itemized billing for [Co. 1]’s services to [Co. 2], staff spoke with [Administrator 1] for procedural clarification. He explained that in cases of indirect subcontractors, the primary ([Co. 2]) pays them separately and directly. [Administrator 1] said

⁶ The BOE does not have FIS forms prior to 2006, because we retain records only for 7 years pursuant to the Local Records Retention Act. 50 ILCS 205/1, *et. seq.*

⁷ The acronyms are as follows: Minority Business Enterprise (MBE), Women’s Business Enterprise (WBE), [redacted].

that the City requires that [Co. 2] report on a “C-2”⁸ the payments it makes to its indirect subcontractors, and the City maintains only the aggregate amount paid to the indirect subcontractor during the contract period. Therefore, Board staff requested [Co. 1]’s monthly invoices directly from [Co. 2] in order to determine whether there was an actual violation of the Ordinance’s FICB provision.

C. Indirect Subcontract with [Co. 2]

[Co. 2] is a manufacturing and supply company [redacted]. In [redacted], [Co. 2] won a 5-year contract, [redacted] [for services]. Under the terms of this contract, [Co. 1] is to provide [services unrelated to the primary contract] to [Co. 2], at a value of \$[redacted] over 5-years, making [Co. 1] an *indirect* City subcontractor.

[Administrator 1] explained to staff that [Co. 1] is an *indirect* subcontractor because its services are not directly related to the subject of the [Co. 2] contract [redacted]. However, he said that, in evaluating contract bids, the City awards credit to companies that use M/WBE’s (and other disadvantaged companies) as direct or indirect subcontractors, and it did with this contract.⁹

Staff spoke with [Co. 2 Owner], [redacted]. [Co. 2 Owner] stated that, for its bid of this contract, [Co. 2] searched [Department B]’s directory of M/WBE firms¹⁰ and found that [Co. 1] provided [redacted] services, a service that [Co. 2] would need. He said that because of [Co. 1]’s M/WBE status, [Co. 2] included [Co. 1] in its bid for this contract specifically to meet the M/WBE quota required by the City and thereby obtain the M/WBE “credit” that ultimately won [Co. 2] the contract. [Co. 2 Owner] said that, but/for [Co. 1]’s M/WBE status, [Co. 2] probably would not have hired [Co. 1]. [Co. 2 Owner] also explained that, if a City contract includes an M/WBE requirement, it does not matter whether the M/WBE firm is a *direct* or *indirect* subcontractor, because the primary contractor has to provide the subcontractors’ business information and certification on the bids regardless.

In addition, [Administrator 1] also explained that certain City contracts mandate that the primary contractor file an affidavit with its bid indicating whether there will be *direct* or *indirect* participation of M/WBE firms. He also confirmed that it does not matter whether the subcontractors’ participation is *direct* or *indirect*, but only that the M/WBE firms’ information is included with the bid for consideration.

D. [Co. 1]’s Monthly Invoices to [Co. 2]

According to the City’s Payment History record for [Co. 1] found on the “C-2” form, the City issued an \$[redacted] payment for [Co. 1] on the [Co. 2] contract [redacted], which covered [an eight month period]. There were no payments reported on the C-2 under this contract prior to [that date]. Based on the monthly invoices that [Co. 1] submitted to [Co. 2], [Co. 1] charged [Co. 2]

⁸ When asked what “C-2” stood for, [Administrator 1] said it was the form that lists contract payment summaries.

⁹ See, the City’s [Department B] rules for M/WBE and disadvantaged companies. <http://www.cityofchicago.org/city/en/depts/dps/provdrs/comp.html>.

¹⁰ [Department B] maintains a public directory of certified M/WBE firms. <https://chicago.mwdbe.com/FrontEnd/VendorSearchPublic.asp?TN=chicago>

[\$redacted] for the same time period. The City issued a \$[redacted] payment for [Co. 1] in [date], which covered [another eight month period]. Based on the monthly invoices that [Co. 1] submitted to [Co. 2], we conclude that [Co. 1] charged [Co. 2] \$[redacted] [for a three month period] pursuant to this indirect subcontract.¹¹ [*The City's payment history record and Co. 2's invoices differed in amounts.*]

[Co. 2 Owner] explained the difference between the amount reported to the City and the invoices by stating that because it is difficult to gauge the actual cost of a service when it involves an *indirect* subcontractor, his company estimated what the anticipated cost would be and included that amount in the bid. If the amount approved in the City contract is lower than the actual cost, then [Co. 2] pays the difference because of its contract with the *indirect* subcontractor. He said that, under its City contracts, [Co. 2] must spend at least the amount provided for in the contract on the *indirect* service, and then report to [Department B] that it has spent that money accordingly. He explained that, because the contractor pays the *indirect* subcontractor directly, it does not matter when the contractor submits this report to [Department B] as long as it reports this information at some point during the life of the contract.

III. LAW AND ANALYSIS¹²

A. Financial Interest in City Business, §2-156-110

Section 2-156-110 of the Ordinance, provides in relevant part:

[N]o elected official or employee shall have a financial interest in his own name or in the name of any other person in any contract, work or business of the City ... whenever the expense, price or consideration of the contract, work, business or sale is paid with funds belonging to or administered by the City, or is authorized by ordinance.

In §2-156-010(1), *financial interest*¹³ was defined, in part, as:

[A]ny interest as a result of which the owner currently receives or is entitled to receive in the future more than \$2,500.00 per year.

This provision prohibits City employees, such as [the Subject], from obtaining a prohibited interest in City business, as will be discussed in more detail below.

B. Indirect Subcontracts Constitute Work or Business with the City

In Case No. 97019.A, the Board applied this provision to a City employee who owned an M/WBE firm who asked whether the Ordinance would prohibit the firm from being listed as a subcontractor on a prime contractor's City contract (for contracts larger than \$10,000). After reviewing the City's procedures on bidding and contracts as they pertain to M/WBE-certified

¹¹ Staff did not calculate beyond July 2012, because [the Subject] was no longer a City employee.

¹² *Supra* FN 5.

¹³ The definition of financial interest was amended on November 1, 2012. This opinion is based on the definition that was in effect at all times relevant to Geralex's subcontract, although this definition expired on October 31, 2012.

companies, the Board determined that contract administrators evaluate “subcontractors listed on the contract bids, as part of their consideration of the contract award [and that] M/WBE subcontractors have a ‘property interest’ in the City contract by virtue of being listed on the bid; they have enforceable rights under the City contract, once it’s awarded.” Since the City included the subcontractor in its evaluation process resulting in awarding the contract, the Board determined that the employee who owned the subcontractor would have a prohibited FICB because its subcontract would have exceeded \$2,500.¹⁴

[Department B’s] rules have separate requirements for M/WBE-certified firms in which the primary contractor must indicate whether there will be *direct* or *indirect* participation of MBE/WBE firms. The distinction between whether a *direct* or *indirect* subcontract constitutes work or business with the City is irrelevant if the subcontractor is an M/WBE-certified firm.

For purposes of this case, the relevant issue is that to obtain the contract, [Co. 2] relied on and submitted [Co. 1]’s M/WBE status information in its bid for the contract, which was a factor for the City when it evaluated the bids. Hence, but for [Co. 1]’s M/WBE certification, [Co. 2] would not have used [Co. 1]. However, since [Co. 1] is encompassed in the [Co. 2] contract, it has its own enforceable obligations/rights, and therefore, for purposes of §2-156-110, its indirect subcontracts constitutes a “contract, work or business” of the City, and its owners would have a financial interest in this subcontract if their ownership interest in [Co. 1] either entitled them to receive, or they actually received, more than \$2,500 in a calendar year.

C. [the Subject] Had a Prohibited Financial Interest in City Business

[The Subject] began his City employment in [redacted] (according to the City’s Listing of Current Employees) and wrote on the City’s “Individual Statement of Ownership form, Attachment 1,” that he, “Started [[Co. 1]] along with wife since its inception” in 2003. [Co. 2] has a City contract and [Co. 1]’s subcontract with [Co. 2] yielded to the [Subject and his wife] income of more than \$2,500 (based on the invoices) [redacted], during the time when [the Subject] was employed by the City. This income thus constitutes a financial interest in City business. Since [the Subject] was owner and helped to manage the business, it was not the independent business of [the Subject’s wife], and this financial interest in City business was ascribed to him. *See*, Case No. 06051.A.

IV. Determination and Recommendation

Based on the facts presented in this opinion, the Board determines that: 1) an indirect subcontract of an M/WBE does indeed constitute a contract, work or business with the City for purposes of

¹⁴ In contrast, in Case No. 93033.A, the Board determined that, because the prime contractor, not the City, was responsible for awarding the subcontract, and the City’s approval was limited only to insuring the reasonableness of the subcontractor’s bid, the subcontractor would *not* have a prohibited FICB. The Board then applied this reasoning in Case No. 96038.Q, when it determined that, because the prime contractor hired and paid its own subcontractor directly, the subcontractor’s interest was in the prime contract and not the City contract. The Board reasoned that a subcontractor that was not listed on the prime contractor’s bid, and therefore was not part of the consideration in awarding the contract, would *not* have a prohibited FICB.

Ordinance §2-156-110; and 2) that [the Subject] violated this Ordinance provision in 2011 and 2012.

After careful consideration, the Board recommends that Department A take the legal action necessary for the City to recuperate the amounts it paid to [Co. 1] in excess of the \$2500 limit permitted for financial interests in City business during the [relevant] period [redacted].

The Board is also assessing [the Subject] a fine of \$1,500. Under §2-156-410(e) which was in effect through October 31, 2012, any person who violated the Ordinance, where, as here, no other penalty was specified, was (and here, is) subject to a fine of not more than \$1,000 for each offense. Violations of this provision are yearly, and [the Subject]'s violation occurred during two years: [redacted], which of course total 24 months. However, [Co. 1]'s contract actually [redacted] totals 18 months, or 75%, of these 24. Thus, the Board hereby assesses a fine equal to 75% of the maximum, or \$1,500.

VI. Reliance

This opinion may be relied on by any person involved in the specific transaction or activity with respect to which this opinion is rendered. Please be reminded that, under the Ordinance, all recommendations of the Board of Ethics are confidential. Therefore, to maintain confidentiality, we request that you not discuss or disclose the information contained in this opinion, except as necessary to address this matter.

Sincerely,

Stephen W. Beard
Board of Ethics, Chair