

Advisory Opinion
[Tom Thompson]
Case No. 04049.A, Interest in City Business

You are the [title X] in Department G. In a letter to the Board, you requested an advisory opinion addressing whether [John Johnson], a [City employee], violated the City's Governmental Ethics Ordinance by virtue of his ownership of a firm that was a disclosed subcontractor on a City contract with another firm for [y] services. The Board has considered this situation, and, with your authority, gathered additional relevant facts. As explained in this opinion, the Board has determined that [Johnson] violated the Ordinance, and that City contract was entered into and performed in violation of the Ordinance. Our analysis and recommendations follow.

FACTS: [Johnson][City employee], and has been employed by the City in that capacity since 199. City records show that he is also the 100% owner of [R], a sole proprietorship, currently located at West F Avenue, Chicago, 606XX. [R] was certified by [B] as a minority-owned business enterprise ("MBE") on 200X. The MBE certification expires on , 200X, but is renewable annually. Materials [Johnson] filed with [B] in which he was applying for MBE certification indicate that he is the 100% owner of [R], and that his ownership in it (and the firm itself) began in 200X. [R]'s principal business activity is listed (in what appears to be [Johnson's] handwriting) as . [His] application included his handwritten completed "Management Resume" form, on which he indicates that he is employed by the [City] as a [Q]. His application also included his federal tax returns for 2001, 2000 and 1999. Each of these had attached to it copies of his W-2 forms from the City .

In reviewing the application [Johnson] filed seeking MBE certification, [B] personnel completed two forms: a "Site Visit Report," and a "Schedule A Summary." The former, dated 200X, indicates that [Johnson] is employed as a [Q], and that [R] "works exclusively for [Contractor N] . All of the jobs that his company takes are from them." It also states that "[Johnson] said that he has no problems with [his Department] with his outside job, and there is nothing wrong that I can see. If the paperwork were correct, I would recommend MBE certification." The Schedule A Summary, completed by [B] personnel and dated August 20, 200x, acknowledges that [Johnson] is a [Q].

On February 2004, the City entered into contract number XXXX (corresponding to Specification number XXXXX) with [J] for services, including . The contract's term is [3 years]

, and the price term is up to \$10,000,000 (it is a Depends Upon Requirements or "DUR"

contract). Section 1.3 of the contract incorporates nine exhibits into the agreement, including Exhibit 3, entitled “MBE/WBE Special Conditions and Schedules.” Section 2.5, entitled “Minority and Women’s Business Enterprises Commitment,” states that “[i]n the performance of this Agreement ... Contractor must abide by the minority and women’s business enterprise commitment requirements of the Municipal Code of Chicago ... except to the extent waived by ...Exhibit 3. Contractor’s completed Schedules C-1 and D-1 in Exhibit 3 ... are a part of this Agreement, upon acceptance by the Chief Procurement Officer.” Schedule C-1 is entitled a “Letter of Intent from MBE/WBE to Perform as a Subcontractor, Supplier and/or Consultant.” It is completed on behalf of [R], which is listed as an MBE participant in the City’s [N] contract, and indicates that [R], a currently certified MBE, is to provide towing services, the value of which is estimated at 2% of the contract, or \$200,000. It is signed by [Johnson], and dated January 28, 200X. Schedule D-1, entitled “Affidavit of MBE/WBE Goal Implementation Plan,” prepared by or on behalf of [N], lists [R] as one of [many] subcontractors. [R]’s percentage of participation in the contract is listed as 2%, with a dollar amount of \$200,000.

Section 2.10 of the contract, entitled “Assignments and Subcontracts,” provides, in relevant part:

All subcontracts and all approvals of Subcontractors are, regardless of their form, considered conditioned upon performance by the Subcontractor in accordance with the terms and conditions of this Agreement. If any subcontractor fails to observe or perform the terms and conditions of this Agreement to the satisfaction of the Department, the City has the absolute right upon written notification to immediately rescind approval and to require the performance of this Agreement by Contractor personally or through any other City-approved Subcontractor. Any approval for the use of Subcontractors in the performance of the Services under this Agreement under no circumstances operates to relieve Contractor of any of its obligations or liabilities under this Agreement.

Contractor, upon entering into any agreement with a Subcontractor, must furnish upon request of the Chief Procurement Officer or the Department [of [V]] a copy of its agreement. All subcontracts must contain provisions that require that the Services be performed in strict accordance with the requirements of this Agreement, [sic] provide that the Subcontractors are subject to all the terms of this Agreement and are subject to the approval of the Department [of [V]] and the Chief Procurement Officer. If the agreements do not prejudice any of the City’s rights under this Agreement, such agreements may contain different provisions than are provided in this Agreement with respect to extensions of schedule, time of completion payments ...

... [The Chief Procurement Officer] may make direct payments to Subcontractors for Services performed under this Agreement. Any such payment has the same effect as if the City had paid Contractor that amount directly.

Section 7.2 of the Agreement, entitled “Ethics,” provides, in relevant part:

(a) ... Contractor warrants: (i) no officer, agent or employee of the City is employed

by Contractor or has a financial interest directly or indirectly in this Agreement or the compensation to be paid under this Agreement except as may be permitted in writing by the Board of Ethics ...

Officials from the Department of [V] confirmed that: 1) [R] was paid more than \$6,245 under this Agreement, for services rendered since January 1 [of the current calendar year]; 2) [N] terminated [R]'s subcontract on or about ; 3) [N] invoices the Department of [V] monthly under the contract and department personnel audit these invoices to ensure that each for which the City is being billed was actually [served]; 4) these invoices do not indicate which subcontractor is actually being paid for the work specified, and department personnel do not become involved in assigning work to particular subcontractors or reviewing how much work has been assigned to particular subcontractors; 5) the Department has not paid any subcontractor directly (this includes [R]), although it has the right to do so; rather, all payments go to [N] , which is responsible for paying its subcontractors; and 6) during the contract award process, the Department was given a list of the subcontractors [N] was proposing, but its review was limited to ensuring that each firm's MBE/WBE certifications were in order.¹

Officials from [B] confirmed that: 1) [B] did not dictate [N] 's choice of subcontractors, but rather, approved them based on MBE/WBE certification; 2) the terms of this contract are standard for all City contracts that involve subcontracting, including but not limited to MBE and WBE situations; 3) [B]'s review of the contract documents in this instance likewise followed standard procedures, and was limited to ensuring that proposed MBE/WBE subcontractors were duly certified; and 4) [B] did not review any disclosures or documents filed by [Johnson] relating to §7.2 of the contract (Ethics), and, to the best of its knowledge, no such disclosures were made.

LAW AND ANALYSIS: The relevant provision of the Ordinance is § 2-156-110, "Interest in City Business," which states in pertinent part:

No 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, or in the sale of any article, 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.

"Financial interest," as defined in §2-156-010(I), means, in relevant part, "(i) any 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; [or] (ii) any interest with a cost or present value of \$5,000.00 or more." As the Board has interpreted these provisions, if a company or firm is owned completely or in part by a City employee, the value of the employee's interest in the firm's City contract or City business is calculated as the amount of the company or firm's contract, work or business with the City, multiplied by the employee's percentage of ownership interest in the company or firm. Case nos. 97019.A; 90077.A. If the interest the City employee has in the City contract yields, or entitles the

1. An official at the Department of [V] also said that, to the best of his knowledge, [R] was a sub-contractor on City contracts with [J] , and received approximately \$5,165 pursuant to its subcontracts, up to June 30, 200X. [J] was subsumed into [N] , and the City's contract was re-bid and awarded to [N] . It is that contract the Board addresses in this opinion.

employee to receive, income of more than \$2,500 per year, or has a cost or present value of \$5,000 or more, then the employee has a prohibited financial interest in City business. The applicable subdefinition in this case is (i), which, the Board recognized in Case No. 97010.A, governs a situation where a City employee or official receives or is entitled to receive money as a result of his or her interest. If the amount of money the employee receives or is entitled to receive from his or her interest in a City contract or in City business is more than \$2,500 per year, the employee has a prohibited financial interest in City business.²

[R] is not (and was not) a City contractor, but, rather, a subcontractor on City contract #1234. [R] 's agreement was with [N] , but that agreement obligated [R] to perform services on, and entitled [R] to be paid by [N] as a result of services performed on, a City contract. The question, then, is whether [Johnson], as the 100% owner of [R] , had an "interest in his own name or in the name of any other person" in the amount of payment [R] receives or is entitled to receive under this subcontract. If the answer is yes, then, under the holding of Case No. 90077.A, he would have a prohibited financial interest in a City contract (because he owns 100% of [R] , and [R] received at least \$6,245 in [the current calendar year] ; moreover, under the contract, [R] became entitled to receive up to \$200,000 [over 3 years]). In Case No. 97019.A, the Board addressed the circumstances under which a City employee would have a prohibited financial interest in a City contract if a firm owned by the employee were to become a subcontractor on a City contract. In that case, the firm was also a City-certified MWBE, and as such its name was required to be listed on the prime contractor's bid proposal, so the City could exercise discretion and evaluate the proposed subcontractor(s). Considering that fact, the Board determined that where

the participation of particular subcontractors is a component in the City consideration of the contract award, it is our opinion that such consideration gives those subcontractors an interest in the City contract and not only an interest in the business of the prime contractor with whom they contract. Accordingly, if [the City employee's] company were to be listed as an MWBE subcontractor on a prime contractor's bid proposal ... the participation of [that] company would be part of the City's consideration of the contract award. That consideration gives [the City employee], as owner of [the company] an interest in the City business, once the contract is awarded.

2. The Board here notes that City contract [1234] entitled [R] to receive up to \$200,000 over a three year period. That raises the issue of whether, under subdefinition (ii) of § 2-156-010(l), [Johnson] had an interest in a City contract "with a cost or present value of \$5,000 or more," and on that basis had a prohibited financial interest in City business. Because the Board's resolution of this case is based on its analysis of this case under subdefinition (i), i.e. on the amount of payment [Johnson] received and was entitled to receive under the contract, the Board need not address or resolve that issue in this opinion. Similarly, the Board notes that, because [R] became entitled to receive more than \$2,500 (up to \$200,000, in fact) over a three year period, it need not address or resolve in this opinion the question whether the phrase "more than \$2,500 per year" in subdefinition (i) applies only to situations where the interest entitles the owner to payments over a period greater than one year. Cf. Case no. 95044.A.

Id., at pp. 4-5.³ The import of Case No. 97019.A, then, is that, if a subcontractor is listed on the prime contractor's bid proposal (whether as an MBE/WBE or otherwise), the participation of that subcontractor becomes subject to the City's approval, and thus the subcontractor has an interest in City business, even though it typically is not paid by the City directly. If the interest the City employee has in the subcontract yields or entitles the employee to receive income of more than \$2,500 per year, then the employee has a prohibited financial interest in City business.

In this case, [R] was listed (as an MBE) on [N] 's contract proposal, as were all [N] 's subcontractors. The City retained significant legal rights as to both [N] and its subcontractors, including the right to approve all of [N] 's subcontractors as well as the terms of any subcontract agreements, and to pay [N] 's subcontractors directly or terminate them (by rescinding its approval of those subcontractors). [R] –thus [Johnson] , by virtue of his 100% ownership of [R] –received more than \$6,245 from its City subcontract, and, by the terms of the City contract, became entitled to receive up to \$200,000 over a three year period. Because these amounts are clearly greater than \$2,500, the Board concludes that [Johnson] had a prohibited financial interest in City contract no. [1234] by virtue of his ownership interest in [R] , a disclosed MBE subcontractor of [N] under that contract.

DETERMINATIONS: The Board determines that: 1) [Johnson] violated §2-156-110 of the Ordinance by virtue of his 100% ownership interest in [R] , a disclosed subcontractor of [N] under City contract no. [1234], as [R] received more than \$6,245 in payment from its subcontract in [the current calendar year] , and by the terms of that contract became entitled to receive up to \$200,000 in payment from it [for a three year period] ; and 2) City contract [1234] was entered into and performed in violation of the Ordinance.

The Board's determinations do not necessarily dispose of all the issues relevant to this situation, but are based solely on the application of the City Governmental Ethics Ordinance to the facts stated in this opinion. If the facts presented are incomplete or incorrect, please notify the Board immediately, as any change in the facts may alter the Board's opinion. Other laws or rules may also apply. The Board notes that any City department may adopt restrictions that are more stringent than those imposed by the Governmental Ethics Ordinance.

RECOMMENDATIONS: Pursuant to §2-156-410(a), the Board recommends that the [G] Department: i) impose employment sanctions as to [Johnson] as it deems appropriate (bearing in mind that the Board's review of the facts presented indicate that [Johnson] appears to have made no attempt to conceal his City employment in any documents filed with the City); ii) advise [Johnson] that, if he is interested in pursuing contracts or subcontracts on behalf of [R] (or any other entity in which he would have a similar ownership interest), he must consider terminating his

3. In Case no. 97019.A, the Board also considered "another factor" in coming to its decision. The other factor was that, under City regulations, an MWBE subcontractor has certain rights under the contract, specifically the right to perform the work and be paid for it by the prime contractor, and to arbitration by a City representative. [B] officials confirmed that subcontractors no longer typically have the right to arbitration by a City representative, but do clearly retain the remaining rights as to the prime contractor. The fact that this right to arbitration no longer exists, however, does not change the Board's analysis, because a City subcontractor, such as [R] , still retains enforceable rights to payments from the City treasury, albeit through the prime contractor, and, moreover, the City retains substantial rights as to the subcontractor (some of which were not operative when the Board issued its 1997 case)—these include the right to approve subcontractors and the terms of subcontract agreements, pay subcontractors directly, terminate subcontractors (by rescinding its approval of them), and require that no City employee or official have a financial interest in the prime contract or any payment made by the City under it.

City employment; and iii) require [Johnson] to attend ethics training. The Board further recommends that the Departments of [V] and [B] implement steps to ensure that documents filed with the City by potential contractors and subcontractors, including applications for MBE or WBE certification, disclosure statements and contract bids, are thoroughly reviewed, specifically with respect to identifying owners of potential contractors and subcontractors who are City employees or officials. The Board also advises the Departments of [V] and [B] that, pursuant to § 2-156-430 of the Ordinance,⁴ they consult with the [P] Department to determine the appropriate action to be taken with regard to [N] as a result of [Johnson's] violation, as well as for failing to comply with § 7.2 of the agreement. Finally, the Board recommends that, if [N] is retained as a City contractor, it, and all of the subcontractors on its City contract, be required by the Department of [V] to complete affidavits attesting to the fact that each of their respective owners and employees have read the City's Governmental Ethics Ordinance and completed the ethics training program for City contractors available on the Board's website at

<http://www.cityofchicago.org/Ethics/Media/EthicsTrainingProgram.html>.

RELIANCE: This opinion may be relied upon by: 1) any person involved in the specific transaction or activity with respect to which this opinion is rendered; and 2) any person involved in any specific transaction or activity that is indistinguishable in all its material aspects from the transaction or activity with respect to which this opinion is rendered.

Darryl DePriest
Chair

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4. Section 2-156- 430, entitled "Invalid Actions," states, in relevant part: "All City contracts shall include a provision requiring compliance with this chapter [i.e. chapter 2-156 of the Municipal Code, the Governmental Ethics Ordinance]. Any contracts negotiated, entered into, or performed in violation of any of the provisions of this chapter shall be voidable as to the City."