

BY NINA MARINO AND BLITHE LEECE

# THE ACCIDENTAL DEFENDANT

## CHARGES OF MISAPPROPRIATION OF PUBLIC FUNDS UNDER PENAL CODE SECTIONS 424, 503, OR 504 ARE NECESSARILY FACT-SPECIFIC

SEVERAL RECENT CASES have targeted individuals for alleged public corruption. Many of those who have been charged, convicted, or acquitted, argued in their defense that they were “just following orders,” “relying on the decision making expertise of others,” or “just unaware of what was going on.” However, in any defense, the merit of the argument is only as good as the facts. Knowing how to advise and protect a client before, during, and after a government investigation can secure a better result.

In the last five years, the Public Integrity Division of the Los Angeles District Attorney’s Office (LADA) has brought several cases alleging misappropriation of public funds and embezzlement by public officials. California broadly defines a public official as “every member, officer, employee or consultant of a state or local government agency.”<sup>1</sup> Public funds are used to finance government functions such as law enforcement, local city government operations, and public schools. Prosecutions for misappropriation are brought under Penal Code Section 424, which prohibits unlawful acts related to public monies, and Penal Code Section 503 or 504, either of which prohibits embezzlement, with Section 504 being specific to embezzlement of public funds by public officials and others.

The most well-covered recent prosecution by the LADA is the City of Bell case, in which the city manager, the assistant city manager, five sitting city council members, and one nonsitting council member were charged with multiple counts of misappropriation of public funds under Section 424 and embezzlement of public money by a public official under Section 504, primarily based upon what the prosecution argued were their overly inflated council member salaries.<sup>2</sup>

The cases of the Bell city manager and the assistant city manager were severed from the five council members, who went to trial first. The council members presented evidence to support that they had no idea that the actions of the council were illegal, that they were generally unsophisticated, and that they were relying on the decision making expertise of the city manager and assistant city manager. After a five-week jury trial, the jury was unable to reach a verdict on half of

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the counts charged as to five of the council members, and a mistrial was declared on those counts. The jury convicted those same five council members on the remaining counts.<sup>3</sup> One council member was entirely exonerated. In interviews after the trial, jurors stated that they believed the exonerated council member was not fully aware of the council's actions and had not voted on the raise in question.<sup>4</sup>

In the Bell case, the defense was a combination of “just following orders,” “relying on the decision making expertise of others,” and “just didn’t know what was going on.” In the context of public corruption prosecutions, the defense has merit because the basis of the organizational structure of a board of directors is to compartmentalize duties and responsibilities in order to increase the functionality of the organization. In fact, in the Bell case, the jury’s inability to reach a verdict on half of the counts charged concerning five of the council members and the outright acquittal of one council member supports the exculpatory value jurors will attribute to a defendant when presented with evidence that the accused was just following orders or was relying on the decision making expertise of one’s more knowledgeable peers.

The defense was able to demonstrate through evidence that the council members were in fact not sophisticated and relied on the expertise of the leadership. At sentencing, the convicted council members received sentences ranging from community service and home arrest on the low end to two years in custody on the highest end.<sup>5</sup> Those sentences, compared with the sentences imposed upon the city manager and assistant city manager, who received sentences exceeding a decade in custody, are relatively modest. Based upon the court’s comments at sentencing, the lesser sentences were imposed in part because the court recognized that the council members were just following orders and relying on the expertise of others.<sup>6</sup>

Similarly, in a jury trial simultaneously taking place across the hall from that of the Bell council members, two charter school operators were accused in a prosecution brought by the same unit of the LADA.<sup>7</sup> This case involved a husband and wife also charged with misappropriating public funds under Section 424 and embezzlement of public funds by public officials under Section 504 from the charter school they founded and operated. Both the husband and wife sat on the board of directors of the school. In trial, the wife’s defense was that her role in the operation was compartmentalized to academics and public relations, that there was a division of duties in the administration, leaving her with little to no substantive involvement in the finances, and that she relied on

the financial expertise of the other board members and deferred to their judgment and decision making. After a six-week jury trial charging 11 felony counts, followed by post-trial motions, the wife was sentenced to probation on a single count of embezzlement. The case is currently on appeal.<sup>8</sup>

### **Stark v. Superior Court**

The pivotal case defining the mental state required for a violation of Section 424 is *Stark v. Superior Court*.<sup>9</sup> *Stark* states that Section 424 is a general intent crime but the defendant must have the mental state as to the legal authorization. In *Stark* the California Supreme Court outlined the elements of a Section 424(a)(1) violation:

As the statutory language provides, it is not simply appropriation of public money, or the failure to transfer or disburse public funds, that is criminalized. Criminal liability attaches when those particular actions or omissions are contrary to laws governing the handling of public money. Unlike many statutory provisions, these provisions make the presence or absence of legal authority part of the definition of the offense. The People must prove that legal authority was present or absent.<sup>10</sup>

The supreme court commented on the unique knowledge component of Section 424: Section 424, however, is an unusual statute, in which the definition of some of the offenses incorporates a legal element derived from other noncriminal legal provisions. Each of the three provisions at issue refers to “law” or “legal duty.” These references are “shorthand,” used to encompass the wide variety of requirements relating to the official’s duties.<sup>11</sup>

The unique, referential nature of Section 424, the supreme court explained, turned the presence or absence of legal authorization to “an essential element of each of the offenses at issue.... Thus, the People must prove, as a matter of fact, both that legal authority was present or absent, and that the defendant knew of its presence or absence.”<sup>12</sup> The legal authorization required in Section 424 is the “authorizing law” that is extraneous to the penal statute. What this means is that the state must prove beyond a reasonable doubt that the legal authority for the action taken, such as an increase in salary, was prohibited by some regulation or rule, and that the defendant knew or should have known of the rule. Under Section 424, if the accused was grossly negligent in failing to know of the rule or regulation, such gross negligence is sufficient for a conviction. It is important to note that Section 424 is not limited to public offi-

cers; it applies to every person with some control over public funds.

The knowledge requirement of the authorizing law plays directly into the “just following orders,” “relying on the decision making expertise of others,” and “just didn’t know what was going on” defense in a prosecution under Section 424. In the Bell and charter school cases, the defense argued that their clients did not know they were doing anything wrong. For the wife in the charter school case and the council members in the Bell case, facts supported the argument that they were relying on the decision making expertise of their more knowledgeable peers. For the accused with a subordinate or compartmentalized role in an organization, these types of defenses can be effective when faced with a violation of Section 424. However, if the accused parties had some measure of control over public funds, they also have a commensurate fiduciary duty over those funds. A person with control over public monies has a fiduciary duty to oversee the spending of those monies in the public interest.

The decision in *Stark v. Superior Court* also led to overturning the conviction of former Compton Mayor Omar Bradley.<sup>13</sup> Bradley served as mayor from 1993 to 2001, and in 2004 he was convicted of misappropriating approximately \$7,500 in public funds by using city-issued credit cards for personal items. Bradley was also accused of taking cash advances for city business expenses and then charging the items to his city-issued credit card, commonly known as “double dipping.”<sup>14</sup> Bradley, along with Compton’s city manager and one city council member, was convicted of misappropriation and misuse of public funds under Section 424 and sentenced to three years in state prison. From the beginning, Bradley’s defense was that he did not know what he was doing was wrong. He believed all his expenses were proper since they were incurred while on the job and the proper authority, the Compton city manager, had approved his spending. He even testified that he had conferred with the city manager regarding many of the expenses and received permission to use the funds for various purposes.<sup>15</sup>

Bradley appealed in 2006, at which time he continued to maintain that he did not do anything wrong because he believed that the credit card charges were legitimate, that he had relied on the expertise of the city manager to approve the expenses, and that he in no way intended to misappropriate funds.<sup>16</sup> Bradley was unsuccessful in that appeal, but that was before the *Stark* decision. By offering a broader reading of the mental state required in a Section 424 offense, the 2011 *Stark* decision echoed Bradley’s defense by stating, “Public officials and others should

not be criminally liable for a reasonable, good faith mistake regarding their legal responsibilities. Nor is section 424 intended to criminalize ordinary negligence or good faith errors in judgment.”<sup>17</sup> Based on this holding, in 2012, California’s Second District Court of Appeal reversed Bradley’s conviction, finding that Bradley “presented evidence, which if credited by the trier of fact, negated his wrongful intent.”<sup>18</sup> Bradley lacked the requisite mental state needed for a Section 424 conviction to stand, which

work for a defendant if the belief by the public official is objectively unreasonable.

Penal Code Section 424 was recently interpreted by *People v. Aldana*,<sup>20</sup> which held that in order to violate Section 424, a person charged with the receipt, safekeeping, transfer, or disbursement of public money within the meaning of Section 424 must also have the approval authority that results in the expenditure of the public funds. The *Aldana* decision caused the reversal of the conviction of the superintendent of the Beverly Hills School

the accused was following orders and believed that he or she was not only allowed to act as alleged but also, in some instances, actually required to do so. The Bell council members argued they were operating under the understanding that they were legally entitled to their high salaries. The wife of the charter school operating team argued that she was functioning under the assumption that those more knowledgeable of financial affairs were making the financial decisions and that she relied on those decisions. Former Mayor Bradley believed that his expenses were proper due to his belief that he had obtained the appropriate city department’s authorization. The superintendent of the Beverly Hills School District argued that he never had the unilateral authority to approve monetary distributions and was just following the orders of the board. Each of these defendants argued in one respect or another that he or she was subject to carrying out the will of a higher authority. The jury verdicts suggest that in most of the jury trials that ensued, the defense resonated to at least some degree. How well this defense is received by a jury is in great part reliant on the functioning structure of the organization, how well the jury understands that structure, and the facts that establish the client’s individual efforts to comply with his or her obligation to protect the public trust.

### Risk Management

Effective representation of individuals under investigation for or accused of public corruption requires that counsel be intimately familiar with the client’s role within the organization and equally familiar with the working of the organizational structure. Any organization, including one regulated under IRC Section 501(c)(3), that receives any public monies has a greater fiduciary obligation because federal and state statutes regulate the use of specially earmarked public funds.<sup>25</sup> Greater board and individual oversight are required for these organizations. Small to medium-sized organizations in which the management team effectively functions as an alter ego of the entity have the greatest ability and incentive to protect board members and executive management.

The board must act and appear independent from the executive management team. A strong working board engaged in the decision making function establishes the board’s independence. Documenting those exchanges in the board minutes is crucial. Failure to maintain a strong and active board of directors can result in allegations being made that the board is a sham or a rubber stamp.

The structure of the board is equally important to preventing the appearance of corruption.<sup>26</sup> The board members must have experience and expertise that collectively fur-



had always been his defense.

In the *Bradley* opinion, the Second District Court of Appeal highlighted the importance of *Stark* as to why a higher mental state must be proven in Section 424 offense cases. Quoting *Stark*, the *Bradley* court observed: “[A] criminal negligence standard protects both the public and the accused. If public officials and others entrusted with control of public funds subjectively believe their actions or omissions are authorized by law, they are protected from criminal liability.”<sup>19</sup> This subjective standard invites introduction of evidence demonstrating that the public official reasonably believed that he or she was not doing anything wrong or was relying on the expertise of others, much like Bradley. However, the broad interpretation of Section 424 will not

District.<sup>21</sup> The charges in that case stemmed from allegations that the superintendent paid the district director of planning and facilities an unauthorized bonus and increased car allowance.<sup>22</sup>

In its opinion, the three-justice panel from California’s Second District Court of Appeal held that state law outlined that the superintendent was not “charged with the receipt, safekeeping, transfer, or disbursement of public moneys.”<sup>23</sup> In overturning the conviction, the court stated: “At trial, it was undisputed that both the increased car allowance and the stipend required approval by the district’s board of education—[the Superintendent] did not have the legal authority to order them unilaterally.”<sup>24</sup>

The common theme in these cases is that



thers the mission and goals of the organization; however, board members cannot insulate themselves from their fiduciary responsibility by compartmentalizing their board role, particularly as related to financial aspects. Finally, before joining any board, the prospective board member should always confirm that the board carries insurance for directors and officers.

A government investigation into an organization's spending of public funds will usually start with gathering documents and records, sometimes as a result of a citizen's seeking records under the Public Records Act or the Brown Act.<sup>27</sup> One method of collection is via a subpoena duces tecum. When an organization receives a subpoena duces tecum from the government, the organization should retain competent counsel to manage the production of documents and records. Records should be created that track the production. When retained by counsel, the attorney work product privilege can protect outside vendor review of large amounts of data necessary for responsive production. In addition, experienced counsel can open a dialogue with the investigative or prosecutorial agency to determine the time period in which response is required and the scope of the request. Trained criminal counsel will frequently be able to learn valuable information in the course of

this dialogue concerning the targets and objectives of the investigation. Sometimes, compliance can be either negotiated with the prosecutor or challenged through the court process if the request is overly broad or improper for any reason.

Law enforcement can also obtain documents and records via use of a search warrant duly authorized by a judge. Execution of a search warrant is disruptive to business operations. In most circumstances many law enforcement agents will be present during the search. Complete compliance in terms of the documents and records identified in the subpoena is the best approach. Therefore, if asked by a government representative where documents and records are stored and kept, a response should be forthcoming. This does not mean, however, that the representative has an affirmative obligation to offer assistance. That said, each circumstance is unique and subject to the differing personalities and tactics in a given situation. Employees should know that they are not required to submit to an interview if approached by a law enforcement agent. Counsel can advise as to the propriety of employees, management, or board members providing statements. The best practice is to contact counsel immediately upon the arrival of law enforcement bearing a subpoena to search and seize.

If an organization has reason to believe financial improprieties are occurring, the organization can proactively conduct its own independent investigation using outside counsel for guidance. If improprieties are discovered, the organization is then in a position to remedy the defect that may include disciplining the wrongdoers and implementing protocol to prevent reoccurrence. Such steps may serve to prevent or mitigate government action.

Individual criminal liability for accusations relating to acts of public corruption is frequently derived from the corporate and administrative structure of the organization that employs the individual. In California, this area of law is evolving as more prosecutions of public officials and those responsible for public monies are brought. For any client who sits on a board of directors for a company receiving public funds, the best advice is to know what is going on, ask questions, and maintain records of activities. ■

<sup>1</sup> GOV'T CODE §82048.

<sup>2</sup> See generally various L.A. TIMES articles on the City of Bell scandal, available at: <http://timelines.latimes.com/bell>.

<sup>3</sup> See *id.*

<sup>4</sup> Carlos Granda, *Bell corruption trial: Luis Artiga acquitted on all charges*, ABC 7 LOS ANGELES EYEWITNESS NEWS, Mar. 20, 2013, <http://abc7.com/archive/19035318>.

<sup>5</sup> Corina Knoll, *Final Bell council member sentenced*, L.A. TIMES, Aug. 1, 2014, <http://www.latimes.com/local/politics/la-me-0802-bell-finale-20140802-story.html>.

<sup>6</sup> *Id.*

<sup>7</sup> *People v. Selivanov & Berkovich*, No. BA372244 (L.A. Super. Ct. 2013).

<sup>8</sup> *People v. Selivanov et al.*, Nos. B252894, B255166 (Ct. App. 2013).

<sup>9</sup> *Stark v. Superior Court*, 52 Cal. 4th 368 (2011).

<sup>10</sup> *Id.* at 395-96.

<sup>11</sup> *Id.* at 397.

<sup>12</sup> *Id.* at 397-98 (emphasis in original).

<sup>13</sup> *People v. Bradley*, 208 Cal. App. 4th 64, 69 (2012).

<sup>14</sup> Abby Sewell, *Court overturns former Compton Mayor Omar Bradley's conviction*, L.A. TIMES, Aug. 3, 2012, <http://articles.latimes.com/2012/aug/03/local/la-me-0802-omar-bradley-20120803>.

<sup>15</sup> *Bradley*, 208 Cal. App. 4th at 76.

<sup>16</sup> *People v. Bradley*, 142 Cal. App. 4th 247 (2006).

<sup>17</sup> *Stark*, 52 Cal. 4th at 400.

<sup>18</sup> *Bradley*, 208 Cal. App. 4th at 80-81.

<sup>19</sup> *Id.* at 78-79 (quoting *Stark*, 52 Cal. 4th at 399).

<sup>20</sup> *People v. Aldana*, 206 Cal. App. 4th 1247 (2012).

<sup>21</sup> *People v. Hubbard*, No. B239519 (Ct. App. 2013) (opinion ordered not published).

<sup>22</sup> Hannah Fry, *Conviction overturned for ex-Beverly Hills schools chief*, L.A. TIMES, Jan. 2, 2014, <http://articles.latimes.com/2014/jan/02/local/la-me-ln-beverly-hills-superintendent-20140102>.

<sup>23</sup> *Hubbard*, No. B239519 at 10.

<sup>24</sup> *Id.* at 3.

<sup>25</sup> See Ralph M. Brown Act, GOV'T CODE §§54950-54963 and Public Records Act, GOV'T CODE §§6250-6270; see also I.R.C. §501(c).

<sup>26</sup> Establishing a Nonprofit Organization, [http://foundationcenter.org/getstarted/tutorials/establish/board\\_dev.html](http://foundationcenter.org/getstarted/tutorials/establish/board_dev.html) (last visited Jan. 21, 2015).

<sup>27</sup> GOV'T CODE §§54950-54963, 6250-6270.



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