FAIR POLITICAL PRACTICES COMMISSION
Memorandum

To: Chairman Randolph, Commissioners Blair, Downey, Huguenin, and Remy

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Subject: Adoption of Amendments to the "Public Generally" Exception to the Conflict-of-Interest Provisions — Regulation 18707.1, and Adoption of Regulation 18707.10.

Date: October 27, 2006

I. EXECUTIVE SUMMARY

This regulatory project examines Commission rules for applying the "public generally" exception of the conflict-of-interest provisions of the Political Reform Act, (the "Act") [1] to a public official's interest in real property. Section 87100 states that no public official "shall make, participate in making, or in any way attempt to use his [or her] official position to influence a governmental decision in which he [or she] knows or has reason to know that he [or she] has a financial interest."

A "public official has a financial interest in a decision… if it is reasonably foreseeable that the decision will have a material financial effect, *distinguishable from its effect on the public generally*, on the official, a member of his or her immediate family," or on any of certain enumerated economic interests. (Section 87103, emphasis added.) An interest in real property is one of these enumerated economic interests.

Under the "public generally" exception provided in regulation 18707.1, the material financial effect of a governmental decision on a public official's real property economic interest is indistinguishable from its effect on the public generally if the decision affects a "significant segment" of the public in "substantially the same manner" as it will affect the public official's economic interest. For real property economic interests, "significant segment" is defined as: (1) "ten percent or more of all property owners or all homeowners in the jurisdiction of the official's agency or the district the official represents;" or (2) "5,000 property owners or homeowners in the jurisdiction of the official's agency."

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[1] Government Code sections 81000 – 91014. Commission regulations appear at title 2, sections 18109-18997, of the California Code of Regulations. All statutory references are to the Government Code unless otherwise indicated.

Accordingly, even if an official has a prohibited conflict of interest under the Act, the official may, nevertheless, participate in the governmental decision if the "public generally" exception is met.

Staff believes that it is appropriate at this time for the Commission to consider revising the provisions of the "public generally" exception as discussed herein. This regulatory project includes proposed amendments to the "significant segment" element of the "public generally" exception for residential properties under regulation 18707.1(b)(1)(B) and clarifying amendments to the "substantially the same manner" test under regulation 18707.1(b)(2). Additionally, this regulatory project includes the adoption of new regulation 18707.10 applicable to small jurisdictions.

First – proposed amendments to the "significant segment" test for residential properties. The proposed amendments to regulation 18707.1(b)(1)(B) would delete the word "homeowners" and substitute the term "residential property owners" in its place.

Second – proposed amendments to the "substantially the same manner" test for real property. The proposed amendments to the "substantially the same manner" test under regulation 18707.1(b)(2) offer a list of factors that a public official would need to consider in determining if the financial effects on his or her property are "substantially the same" as the financial effects on a significant segment of other property owners within the jurisdiction or district.

Third – adoption of regulation 18707.10. Finally, a new regulation applicable solely to a public official's economic interest in his or her domicile when the public official resides in a small jurisdiction is presented for adoption or further refinement. This regulation is a recodification of most of the provisions of the original "public generally" exception for small jurisdictions adopted in 1990. Although the Commission repealed the small jurisdiction exception in February 2003 when it reduced the boundaries applicable for the directly/indirectly involved property test to 500 feet for all decisions, because of continuing concerns raised by representatives of small jurisdictions, a similar regulation is now presented for Commission consideration.

II. BACKGROUND

This regulatory project was initiated, in part, by a letter the Commission received in August 2005 from Lisa Foster in San Diego County raising issues regarding the application of the "public generally" exception to residential property in small cities with a high rate of vacation rentals. (See Letter to Commission from Lisa A. Foster, August 22, 2005, attached).

As an attorney representing a number of small municipalities in San Diego County, including Solana Beach and Imperial Beach, where many of the properties are used as vacation rentals, Ms. Foster pointed out that in many cases public officials who owned their residence were precluded from applying the "public generally" exception

because residential rental properties were not included in determining the significant segment, even though the values of those properties were affected in substantially the same manner as identical properties that were not being rented. Because of this, the "significant segment" test was difficult to meet. (See discussion under Decision Point 1).

On July 11, 2006, staff held an Interested Persons meeting to receive public input regarding possible amendments to the regulations regarding the "public generally" exception, including areas of concern regarding interpretation of the "significant segment" and "substantially the same manner" tests used to apply the exception. During that meeting, three separate areas of concern were raised by the participants that are addressed in the proposed amendment herein:

First: As addressed in the *Foster* letter, in determining the "significant segment" for financial effects on real property, regulation 18707.1 uses the term "all property owners" or "all homeowners." The term "homeowners" does not include owners of homes that are used as rental properties. The Commission was asked to consider modifying the regulation to include the previously deleted term "households," or some other appropriate term, that would allow the consideration of all residential property in determining a significant segment. At the September Commission meeting the Commission directed staff to bring back for adoption in November: Decision Point 1 regarding the proposed amendments to regulation 18707.1 deleting the word "homeowner" and substituting, in its place, the term "residential property owner," and to include within the definition of residential property, multi-family structures of *four* units or fewer. This issue is addressed in **Decision Point 1**.

Second: The general response at the meeting was that the Commission should develop a list of factors that needed to be considered to determine whether financial effects are considered "substantially the same." In other words, what factors does a public official need to examine in comparing his or her property against other properties in the significant segment to determine if the financial effects of a decision are substantially the same? This issue is addressed in **Decision Point 2**.

Third: Some interest has been raised concerning the need for the Commission to reconsider a separate "public generally" exception for small jurisdictions. The issue raised is that public officials involved in decisions in small jurisdiction commonly live within 500 feet of the governmental decision and are presumptively precluded from participating in the decision. Because limited resources of these jurisdictions may restrict the use of the "public generally" exception, these officials, it is claimed, routinely decline to participate in the decision to avoid any possible conflict of interest. Accordingly, the Commission is asked to consider returning to the previous 300 foot rule for jurisdictions below a certain size. This issue is addressed in **Decision Point 3**, which would add a special rule under regulation 18707.10 for application of the "public generally" exception to small jurisdictions.

With respect to the proposed adoption of regulation 18707.10 the Commission directed staff to return with this proposal in November in order to provide sufficient opportunity to receive public comment on the proposal.[2]

III. DISCUSSION OF AFFECTED REGULATIONS

Decision Point 1: Amend regulation 18707.1(b)(1)(B)(i) and(ii) to delete the word "homeowner" and insert the term "residential property owner." The above subsections provide the significant segment threshold necessary to meet the first part of the "public generally" exception for an economic interest in real property as follows:

> "(B) Real Property: For decisions that affect a public official's interest in real property, the decision also affects:
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> (i) Ten percent or more of all property owners or all homeowners in the jurisdiction of the official's agency or the district the official represents; or
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> (ii) 5,000 property owners or homeowners in the jurisdiction of the official's agency."

Because, the term "homeowner" has been defined as "an individual who owns residential property that is his or her domicile or principal place of residence" (*Furth*, Advice Letter No. A-99-035, *Nerland* Advice Letter, No. I-02-059; *Doi* Advice Letter, No. I-04-076; *Brewer*, A-04-233), it does not include owners of residential property who rent their property to others. Accordingly, by virtue of the fact that the owner does not live in the property, he or she was not considered a "homeowner."

Because the value of a property, or a financial affect on a property, is not determined by who lives on the property, the exclusion of non-resident owners of residential property from the definition of "homeowner" does not appear to have any rational basis for support. Although the financial effects may be identical on all owners of the residential properties, under the current regulation only the owners who reside on, as opposed to rent, their properties may be counted toward the significant segment.

While residential rental property owners are included under the broader definition of all "property owners," because this class also includes commercial, industrial, and all other types of property owners, the "ten percent or more" threshold for the significant segment is even more difficult to meet. The intent of the regulation appears to be to create two distinct groups in determining the significant segment for decisions affecting real property. The first group includes all real property owners, while the second group

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[2] At the September meeting, there was no public comment received on this proposal. Staff was later informed that the September meeting, which had been rescheduled, was held at the same time as the League of Cities fall meeting in Southern California. Staff expects that sufficient public comment will be offered at the November meeting for the Commission to receive appropriate input for its consideration.

appears to concern residential property but, in actuality, is limited to residential property on which the owner lives. Presumably, these classes reflect the fact that decisions affect residential property differently from other types of property.

However, by limiting the definition of homeowners to an individual who owns the home in which he or she lives, owners of non-owner occupied homes are excluded, even thought the financial affects on an official's residence are more properly measured against the financial effects on a similar non-owner occupied home.

The proposed amendments to regulation 18707.1(b)(1)(B) would substitute the term "residential property owners" for "homeowners," and define residential property to include single family homes, multi-family buildings consisting of four units or less, and condominiums. Other minor clarifying amendments are also offered.

Staff Recommendation: Staff recommends that the Commission adopt Decision Point 1. Staff believes that providing and defining a separate term would be less confusing than redefining the term "homeowners." (For a thorough discussion of the background of this issue see, staff memorandum to the Commission, *Prenotice Discussion of Amendments to the "Public Generally" Exception to the Conflict-of-Interest Provisions — Regulation 18707.1, and Adoption of Regulation 18707.10*, dated August 24, 2006.)

Decision Point 2: Amend regulation 18707.1(b)(2) to provide a list of factors to be considered in determining the financial effects on real property.

Staff received input at the interested persons' meeting that suggested it would be helpful if the Commission provided a list of factors relevant in a public official's determination of the comparable financial effects on his or her real property versus other properties in the significant segment. Decision Point 2 proposes a new subsection under the "substantially the same manner" test providing 13 factors to be considered in comparing properties to determine if the financial effects are similar.

Under the "public generally" exception, once a determination is made that a governmental decision will affect a significant segment as defined in regulation 18707.1(b)(1), the second prong of the test requires that the interests of the members of the "significant segment" be affected in "substantially the same manner" as the interests of the public official for the exception to apply. This second prong is provided in regulation 18707.1(b)(2):

> "(2) Substantially the Same Manner: The governmental decision will financially affect a public official's economic interest in substantially the same manner as it will affect the significant segment identified in subdivision (b)(1) of this regulation. The financial effect need not be identical for the official's economic interest to be considered "financially affected" in "substantially the same manner."

Essentially, what the regulation states is that once it has been determined that the property values of a group of people will be influenced by a governmental decision, the financial or monetary result from that influence must be substantially the same for the official's property as it is for the property of the group affected. For this reason, the Commission has advised that financial effects are measured in terms of overall dollar effects and not by fixed percentage affects. (See *Berger* Advice Letter, No. A-05-054). The first sentence of Decision Point 2 codifies that advice.

The remainder of the proposed language in Decision Point 2 sets out factors to be considered in determining whether or not the financial effects resulting from the governmental decision are substantially similar for the official's property as they are for other property owners affected by the decision. The factors set forth under this decision point are intended to provide guidance to public officials by offering a checklist of factors to help assist in their determination. (For additional discussion on this decision point, see staff memorandum to Commission, *Prenotice Discussion of Amendments to the "Public Generally" Exception to the Conflict-of-Interest Provisions — Regulation 18707.1, and Adoption of Regulation 18707.10*, dated August 24, 2006.)

Staff Recommendation: Staff believes that the factors listed in the language contained in Decision Point 2 would provide helpful guidance to public officials in applying the "substantially the same manner" prong of the "public generally" exception and, for that reason, recommends that the Commission adopt Decision Point 2.

Decision Point 3: Small Jurisdictions: Adopt regulation 18707.10 to provide a "public generally" exception applicable to real property owned by a public official that is used as his or her domicile in small jurisdictions.

In February 2003, the Commission repealed a specialized form of the "public generally" exception applicable to small jurisdictions. The original regulation, regulation 18703.1, adopted in October 1990, grew out of a concern from smaller jurisdictions about the impact of the new, definitive materiality regulations that had been adopted the year before. (Regulations 18702.1 through 18702.6.) The specific issue that resulted in the enactment of regulation 18703.1 was the application of regulation 18702.3[3] to the City of Signal Hill, where the city attorney found that, when applying the 2,500 foot materiality rule, virtually all of the public officials (council members and planning commissioners) resided within 2,500 feet of the site. (*Cosgrove* Advice Letter, No. I-92-536.)

[3] Under that regulation, the effect of a governmental decision was deemed to be material if an official's property was within 300 feet of the boundaries of the subject property and not to be material if located beyond 2,500 feet of the boundaries. For property in which the official had an economic interest that was located outside a radius of 300 feet but within a radius of 2,500 feet of the boundaries (or the proposed boundaries) of the real property which was the subject of the decision, the effect of the governmental decision was deemed to be material if there was a reasonably foreseeable financial effect of $10,000 or more on the market value or if its rental value was increase or decreased by $1,000 in a 12-month period

In response to Signal Hill's concerns and those of other small jurisdictions, regulation 18703.1 was developed to permit public officials to participate in decisions that affect their personal residences under certain limited circumstances. (See staff memorandum to Commission, October 23, 1995.) The small jurisdiction exception applied only when the property was located in the middle ground (between 300 and 2,500 feet) delineated in the regulation. (For a complete discussion of the history and purpose of the "public generally" exception for small jurisdictions, see staff memorandum to Commission, dated August 23, 2002.)

The small jurisdiction regulation was amended several times and eventually renumbered as regulation 18703.1.

As part of the Phase 2 regulatory changes, the materiality standards for real property changed, and the 300 – 2,500 foot radius was eliminated. It was replaced with the current rule providing a presumption of materiality if the property is located within 500 feet of the subject of the governmental decision and a presumption of nonmateriality if the official's property is beyond 500 feet.

In February 2001 the small jurisdiction "public generally" exception was amended to conform with the Phase 2 changes, changing the 300 foot distance to 500 feet. In September 2002 the Commission began consideration of amending or deleting the small jurisdiction exception. The issue was framed as: "[s]hould regulation 18707.3, the "public generally" exception applicable to small jurisdictions, be revised to revert to its pre-Phase 2 rule [300 feet]? In the alternative, have Phase 2 amendments created less need for the exception?" (Staff memo, dated August 23, 2002, *supra.*)

In examining these issues, staff received substantial input from representatives of small jurisdictions, who argued that the new 500-foot rule created a situation where the radius of 500 feet from each of the residences of their public officials encompassed much of the jurisdiction. These representatives stated that the 500-foot rule was too restrictive in small jurisdictions, forcing them to determine in many instances whether a public official may participate under the "public generally" exception. Because of the need to gather material facts to examine financial effects in order to apply this exception, it taxed the limited resources of many small jurisdictions, and they argued that the process was too burdensome. Oftentimes they were forced into applying the legally required participation exception, making the potential outcome of the decision subject to the "luck of the draw."

While the elimination of the so called "donut rule" made it no longer necessary, in most cases, to examine financial effects on a public official's property if it was located beyond 500 feet of the property that was the subject of the decision, it also expanded the minimum boundaries for applying the small jurisdiction exception from 300 feet to 500 feet. This 200-foot expansion is the source of continuing concerns from small jurisdictions as to the need for a special "public generally" exception for those jurisdictions.

The other result of the Phase 2 amendments was to effectively eliminate any practical use for the small jurisdiction "public generally" exception, since it was only applicable to property located in the middle ground – between 500 and 2,500 feet. Because the middle ground was eliminated, and the new rule created a presumption that property located beyond 500 feet from the governmental decision was not materially affected, absent special circumstances rebutting that presumption, there was no longer any practical use for the exception under the new radius.

As a result, the Commission explored the alternatives of reducing the radius for presumed materiality for small jurisdictions to the original 300 feet or eliminating the small jurisdictions rule altogether. Commission staff, including the Enforcement Division, argued against creating a new rule for public officials in small jurisdictions with residences beyond 300 feet but within 500 feet of the subject property because it would allow them to participate in, decisions in which officials in larger jurisdictions would be prohibited from participating in despite the existence of the same factors. In the end, the Commission decide to repeal the "public generally" small jurisdictions regulation.

Since that time, representatives of small jurisdictions have expressed concern as to the effects of this action. At the Interested Persons' meeting, representatives of small jurisdictions discussed the difficulties and costs associated with applying the "public generally" exception and the frequency in which this issue arises because of the increase in distance for the materiality standard from 300 to 500 feet. They have asked that the Commission reconsider this issue as part of its examination into revising the "public generally" rules.

For that reason, staff offers the proposed language in Decision Point 3 addressing this issue. The language offered is a modified version of the original language creating the "public generally" exception for small jurisdictions. Staff seeks Commission direction as to whether or not the language presented is necessary and appropriate to meet the concerns of small jurisdictions in addressing any real problems associated with applying the "public generally" exception in the areas, and is prepared to make any adjustments to the proposed amendments at the Commission's direction after considering any public comment received.

Staff Recommendation: Staff makes no recommendation on this Decision Point.

Attachments

Proposed amendments to regulation 18707.1
Proposed regulation 18707.10