

# State of California



## Fair Political Practices Commission

P.O. BOX 807 • SACRAMENTO, 95804 • • • 1100 K STREET BUILDING, SACRAMENTO, 95814

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February 28, 1985

Geoffrey L. Hayden  
Deputy City Attorney  
City of Fresno  
P.O. Box 1271  
Fresno, CA 93715-1271

Re: Your Request for Advice  
Our No. A-84-319

Dear Mr. Hayden:

You have requested advice on behalf of the two retirement boards of the City of Fresno. Because of the voluminous materials submitted by yourself and by counsel for TCW Asset Management Company ("TAMCO"), I have requested and you have agreed to an extension of time in which to respond. It has also taken time in which to collect all of the material facts related to the request, which has been gleaned from your letter and materials, TAMCO's counsel's letter and materials, and telephone conversations with both of you and with other City staff.

### FACTS

The City of Fresno has two retirement funds. One is for police and fire employees, the other is for the remainder of City employees. Each fund is governed by a board of five members. The Mayor and another Councilmember sit on each board. Each board has three other members. Two of these must be employees of the member groups, elected by their peers. The fifth member is selected from the "citizenry" by a vote of the other four. (For convenience the two retirement boards will be referred to collectively as the "boards.")

The employee retirement funds are invested under the boards' direction and pursuant to policies established by the boards as to type, quality, and diversity of investments. The boards have retained the services of TAMCO, to manage their investment portfolios.

Trust Company of the West ("TCW") is an independent trust company chartered by the State of California and regulated by

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the State Banking Department. The Company is qualified as a corporate fiduciary to act as an investment adviser, trustee and custodian. TAMCO, a wholly-owned subsidiary, is registered with the Securities and Exchange Commission as an investment adviser under the Investment Advisers Act of 1940.

Managing investment portfolios is TCW's only business. TCW is not a division, subsidiary, department, or partner of any bank, brokerage firm, insurance company, or mutual fund organization. Majority ownership rests with management, with the remaining equity held by directors and a limited number of outside shareholders.

TCW specializes in the management of corporate pension and profit sharing funds--endowment funds--union retirement and health and welfare funds--public employee retirement funds--and other pools of capital. TAMCO manages over \$5 billion for approximately 60 institutional clients.

At present, the Fresno retirement funds' combined assets equal approximately \$152 million. As to most investment decisions, TAMCO employees are given complete discretion, subject to standards of prudence and the investment policies established by the boards. However, certain categories of investment are not authorized under the agreement between TAMCO and the boards. Therefore, as to those categories, TAMCO must recommend to the boards, who make the actual decisions.

On occasion TAMCO employees have decided that an investment in a fund managed by TAMCO's parent company, TCW, would be of benefit to the retirement funds' investment objectives. In each instance, including the present, the TCW-managed investment has been of a type which is not authorized under the agreement. Thus, TAMCO employees have only recommended such a decision to the boards. To date, the funds have invested in three such investment vehicles managed by TCW. A total of \$5 million was invested in TCW Realty Fund I (RF1); a total of \$13 million in TCW Special Equity Fund (SEF); and a total of \$5 million in TCW Realty Fund II (RF2). Thus, \$23 million of the current \$152 million in retirement fund assets is invested in these three TCW-created investment vehicles. In each instance, TAMCO employees have disclosed that TAMCO is TCW's wholly-owned subsidiary and have described the fees to be earned by TCW for managing the funds' investments. In the aggregate for the three investments to date, totalling \$23 million, TCW has earned first-year fees of \$231,000, or approximately 1 percent. The total fees which TCW received from all investors in these funds for the same time period was \$5,810,000.

Currently, TAMCO's employees have recommended to the boards that they invest another \$7 million in another TCW-managed fund, TCW Commingled Debt and Royalty Fund II ("DRF2"). This investment would represent approximately 5 percent of the funds' combined assets. The fire and police fund would invest \$3 million while the city employee fund would invest \$4 million.

The combined \$7 million investment in DRF2 will result in fees to TCW of between \$157,000 and \$200,000 in the first year.<sup>1/</sup> Because the \$7 million investment would be diverted from being managed by TAMCO, its revenues would be reduced by approximately \$14,000 during the first year.<sup>2/</sup> The potential difference to TCW from the proposed investments of \$7 million is thus \$143,000 to \$186,000 in the first year. TCW's overall annual gross revenues are approximately \$25 million, with \$14.9 million of that amount being earned by TAMCO.<sup>3/</sup>

#### QUESTION

Are TAMCO's employees "public officials" within the meaning of the Political Reform Act and, if so, are they required to disqualify themselves with respect to recommendations to the boards that the boards make investments in DRF2?

#### ANALYSIS

In their letter on behalf of TAMCO, O'Melveny & Meyers has urged that neither TCW, TAMCO nor any of its employees falls within the purview of the Political Reform Act because none of these meets the definition of "public official" within the meaning of the Political Reform Act.<sup>4/</sup> If that is the case,

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<sup>1/</sup> This is based upon conversations with Howard Chao and Eric Schunk of O'Melveny & Myers, counsel for TAMCO. The difference between \$157,000 and \$200,000 is that the lower sum assumes no royalties in the first year whereas the higher sum assumes all royalties accruing in the first year of operation. The sum would be apportioned on a pro rata basis to each of the two funds. The total management fees expected to be earned by TCW in the first year of DRF2 from all members is between \$2-1/2 million and \$6 million.

<sup>2/</sup> This figure is also based upon conversations with Mr. Chao and Mr. Schunk.

<sup>3/</sup> Id.

<sup>4/</sup> Government Code Sections 81000-91015. All statutory references are to the Government Code. See specifically Section 82048 and Commission regulation, 2 Cal. Adm. Code Section 18700.

the Act's disqualification provisions would not apply. They have urged that this is so because on the particular questions involved TAMCO's employees only recommend to the boards but have no authority to take action. It is conceded, however, that TAMCO's employees do make decisions as to other investment transactions for the boards in managing their portfolios. Consequently, we will address that matter first.

The Act prohibits "public officials"<sup>5/</sup> at any level of government from making, participating in making, or using their official position to influence the making of a government decision whenever the officials know or have reason to know that they have a financial interest in the decision.

The focus of the analysis by counsel for TAMCO and of their arguments has been on Commission regulation 2 Cal. Adm. Code Section 18700, specifically subdivision (a)(2) which defines the term "consultant" as used in Section 82048.

(a) "Public official at any level of state or local government" means every natural person who is a member, officer, employee or consultant of a state or local government agency. . .

(2) "Consultant" shall include any natural person who provides, under contract, information, advice, recommendation or counsel to a state or local government agency, provided, however, that "consultant" shall not include a person who:

(A) Conducts research and arrives at conclusions with respect to his or her

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<sup>5/</sup> Section 82048 defines "public official" as follows:

"Public official" means every member, officer, employee or consultant of a state or local government agency, but does not include judges and court commissioners in the judicial branch of government. "Public official" also does not include members of the Board of Governors and designated employees of the State Bar of California, members of the Judicial Council, and members of the Commission on Judicial Performance, provided that they are subject to the provisions of Article 2.5 (commencing with Section 6035) of Chapter 4 of Division 3 of the Business and Professions Code as provided in Section 6038 of that article.

rendition of information, advice, recommendation or counsel independent of the control and direction of the agency or of any agency official, other than normal contract monitoring; and

(B) Possesses no authority with respect to any agency decision beyond the rendition of information, advice, recommendation or counsel.

2 Cal. Adm. Code Section  
18700(a)(2)

More specifically, TAMCO's counsel relies on the provisions of subdivision (B) in making the contention that as to these particular decisions TAMCO employees "possess no authority...beyond the rendition of information, advice, recommendation or counsel." Thus, TAMCO's counsel contends, TAMCO's employees are not "consultants" when recommending that the boards invest in TCW managed investments.

TAMCO's counsel has also made a related argument, that since the boards' contract is with TAMCO, not its employees, and since TAMCO is not a "natural person," then there is no "consultant" at all, even for those situations where TAMCO's employees do, in fact, make investment decisions for the boards. The use of the term "natural person" in subdivision (a)(2) of regulation 18700 was for the purpose of clarifying that corporate entities need not file Statements of Economic Interests. If counsel's argument were accepted, all consultants could simply avoid the provisions of the Act by incorporating themselves. The definition in subdivision (a)(2) of regulation 18700 was not intended to provide such a loophole. We have consistently advised to the contrary. See the following previous advice letters: Letter to Gerard Rose, No. A-84-307; and Letter to David Kaplan, No. A-82-108, copies enclosed.

Returning to counsel's argument that TAMCO employees, who are clearly "consultants" when making the investment decisions for which they are hired, under contract, are nevertheless not "consultants" when they only recommend an investment to the boards, we are not persuaded.

First, the language of subdivision (a)(2)(B) of the regulation provides that a person is not a consultant if he or she:

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Possesses no authority with respect to any agency decision beyond the rendition of information, advice, recommendation or counsel. (Emphasis added.)

Clearly, TAMCO's employees possess not just some authority but full authority with respect to many agency decisions, since they handle virtually all of the board's investment decisions under TAMCO's contract. Thus, under the wording of the regulation, they are not exempt. Furthermore, as "consultants" they are clearly "participating" in the boards' decisions in the matters here in question because they are advising and making recommendations to the decision-makers, "without significant intervening substantive review." 2 Cal. Adm. Code Section 18700(c)(2).

In the Commission's Maloney Opinion, 3 FPPC Opinions 69 (No. 76-082, Aug. 18, 1977), the Commission held that a contract county surveyor-engineer was not a consultant when performing specific engineering or surveying work because in so doing he was "not involved in any official decision making." The Commission went on to state:

Our answer to this question assumes that in his role as county surveyor, the contractor has no say in determining the extent of the contract work he and his firm will perform for the county. It is our understanding that the contractor has no such say. If, in his role as county surveyor, the contractor could determine the extent of contract work for his private firm, there would be a conflict of interest requiring disqualification. (Emphasis added.)

3 FPPC Opinions 69 at 71.

Here, TAMCO employees do have a say in the question of how much work their parent firm, TCW, will do for the boards. In the Maloney Opinion, the Commission went on to suggest that an engineer without a conflict could be brought in to review those matters where the contract county surveyor-engineer would have a conflict of interest require disqualification. A similar approach was agreed upon by the parties in the situation addressed by our recent advice letter to Gerard Rose, No. A-84-306, supra, copy enclosed.

Having resolved the question of TAMCO's employees being "consultants" we turn now to the issue of whether the decision to recommend that the boards invest in DRF2 is one requiring TAMCO's employees to disqualify themselves. Before disqualification will be required, the reasonably foreseeable effect of the decision must be material and distinguishable from

the effect upon the public generally, upon an economic interest of the consultant.

We can dispose of the public generally issue rather simply: no one else in the public will be affected in a manner similar to the effect upon either TAMCO or TCW.

TAMCO's employees have an economic interest in TAMCO under Section 87103(c) and (d). Pursuant to Commission regulation 2 Cal. Adm. Code Section 18706 an effect on the parent of TAMCO (TCW) will be disqualifying if it is material as to TCW.

An official has a financial interest in a decision within the meaning of Government Code Section 87100 if it is reasonably foreseeable that the decision will have a material financial effect, distinguishable from its effect on the public generally, on a business entity which is a parent or subsidiary of, or is otherwise related to, a business entity in which the official has one of the interests defined in Government Code Section 87103(a), (c) or (d).

Turning to materiality, the two issues to be resolved are whether the effects upon TCW of the two boards' decisions should be aggregated or not, and, once that is resolved, what standard should be applied for measuring materiality.

The investment decisions made directly by TAMCO employees and those made directly by the boards have all been identical as to the two boards. The two funds each participate in the same investments and are managed jointly by TAMCO's employees. The two boards meet at the same time and location and consider matters concurrently because of their overlapping membership. Consequently, the recommendation by TAMCO's employees could be considered as being really for \$7 million to be invested rather than for \$3 million and \$4 million separately.

The net combined effects upon TCW will be between \$143,000 and \$186,000 in the first year. We compare this with the guidelines set forth in Commission regulation 2 Cal. Adm. Code Section 18702(b) (1).<sup>6/</sup>

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<sup>6/</sup> We note that a change in this regulation has been noticed; however, it is not yet in effect. The Commission has authorized staff to render advice based upon a higher limit for companies traded on the New York Stock Exchange and the American Stock Exchange. TCW is owned by its directors and is not traded on either exchange, consequently, the higher figure does not apply.

(b) In determining whether it is reasonably foreseeable that the effects of a governmental decision will be significant within the meaning of the general standard set forth in paragraph (a), consideration should be given to the following factors:

(1) Whether, in the case of a business entity in which the public official holds a direct or indirect investment of one thousand dollars (\$1,000) or more or in the case of a business entity in which the public official is a director, officer, partner, employee, trustee or holds any position of management, the effect of the decision will be to increase or decrease:

(A) The annualized gross revenues by the lesser of:

1. One hundred thousand dollars (\$100,000); or

2. One percent if the effect is one thousand dollars (\$1,000) or more; or

(B) Annual net income by the lesser of:

1. Fifty thousand dollars (\$50,000); or

2. One half of one percent if the effect is one thousand dollars (\$1,000) or more; or

(C) Current assets or liabilities by the lesser of:

1. One hundred thousand dollars (\$100,000); or

2. One half of one percent if the effect is one thousand dollars (\$1,000) or more.

Current assets are deemed to be decreased by the amount of any expenses incurred as a result of a governmental decision.

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Under the test to be applied, if TCW's annualized gross revenues will be affected by \$100,000 or more, then the effect will be considered material. Even if the effects were not aggregated, the effect of the \$4 million decision of the one board alone would range between \$82,000 and \$106,000.

We are not able to resolve the aggregation question at this time because it is really a factual one best determined by you and the boards. The answer will hinge on whether the boards would act together on the recommendation or take separate, distinct, and possibly different actions.

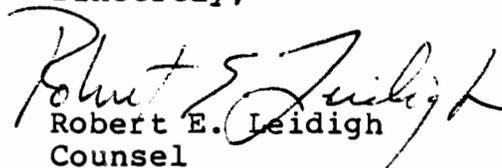
Likewise, we are unable to determine the exact amount of the additional fees to be earned by TCW as a result of the individual decisions of the boards. Clearly, if the first-year royalties are on the high side, the additional amount from the \$4 million decision of the one board could equal or exceed the \$100,000 standard for materiality.

Again, these are factual questions best left for your determination. If it is your feeling that the two boards' decisions should be treated as one decision, then it is clear that a material financial effect is reasonably foreseeable and TAMCO's employees must disqualify themselves from making or participating in making such a decision.

We offer the following comments. You might want to consider selecting an independent financial adviser to review and make recommendations on proposed investments in TCW managed funds. If City staff is competent to perform this function, staff could act in this capacity. We have also been advised that board members are not currently designated officials under the City of Fresno's Conflict of Interest Code. Both the board members and the TAMCO employees who handle the funds' investments should be designated in the City's Code and should be filing Statements of Economic Interests.

If you have further questions regarding this matter, please do not hesitate to contact me. I may be reached at (916) 322-5901.

Sincerely,

  
Robert E. Leidigh  
Counsel  
Legal Division

REL:plh  
Enclosure  
cc: Eric Schunk  
Howard Chao  
O'Melveny & Meyers

City of



James A. McKelvey  
City Attorney

DEC 17 8 51 AM '84

December 13, 1984

Fair Political Practices Commission  
Mr. Robert Leidigh  
Attorney at Law  
P. O. Box 807  
Sacramento, California 95804

Re: FPPC Conflict of Interest/City of Fresno  
Retirement Board and TCW

Pursuant to our conversation of December 12, 1984, enclosed is the information I could compile on Trust Company of the West.

As you recall, the City of Fresno has two retirement boards, one representing the Fire and Police and the other representing the City Employees. The combined retirement boards, by contract, hired TCW as their investment advisor with authority to invest prudently without approval from the boards.

TCW on three prior occasions, with full disclosure, has acted as a broker and suggested to the boards that they invest in TCW's parent company. TCW was under the assumption that as long as they made full disclosure there would be no conflict with their position as advisor to the boards. The boards accepted this position and invested as advised. (See enclosure.)

TCW is now proposing another 7 million dollar investment by the boards into their parent company. At present the total portfolios value is approximately 152 million with approximately 22 million invested in TCW's parent company.

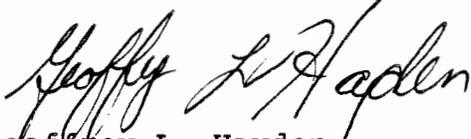
The retirement boards have asked that the conflict question be re-evaluated with particular emphasis on the Political Reform Act.

It would be my opinion that California Government Code Sections 87100, 82041 and 82048 preclude TCW investment advisor from suggesting that the boards invest in their parent company. Such a proposal creates a conflict of interest under the Political Reform act and may also be prohibited by California Government Code Section 1090. (See enclosed.)

Would you please review the enclosed materials and render an opinion. If you agree, would you please advise aa to what should be in regards to the three prior investments.

The retirement boards will meet aagain in the middle of January, 1985. It is hoped that a final decision as to this issue can be rendered at that time.

Your anticipated cooperation is appreciated. Please return all documents if possible. If you have any questions, please do not hesitate to call. Thank you.

A handwritten signature in cursive script, reading "Geoffrey L. Hayden". The signature is written in dark ink and is positioned above the typed name.

Geoffrey L. Hayden  
Deputy City Attorney

GLH/zzd  
6880/

Enclosures