California Fair Political Practices Commission

M E M O R A N D U M

To: Chairman Getman, Commissioners Downey, Knox, Scott and Swanson

From: John Wallace, Assistant General Counsel
Luisa Menchaca, General Counsel

Re: Status Update/Pre-notice Discussion: "Reasonably foreseeable" material financial effect standard (Section 87103/Regulation 18706.)

Date: October 2, 2001

I. INTRODUCTION/BACKGROUND

In February 1999, at the request of the South San Francisco City Attorney (supported by the California Association of Realtors), the Commission began consideration of a regulation defining reasonable foreseeability. Staff has conducted numerous working group meetings on the issue.[1]

II. APPLICABLE LAW

Since its adoption by the voters in 1974, the Political Reform Act has provided:

> "No public official at any level of state or local government shall make, participate in making or in any way attempt to use his official position to influence a governmental decision in which he knows or has reason to know he has a financial interest." [Section 87100.]
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> "A public official has a financial interest in a decision within the meaning of 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 the official, a member of his or her immediate family, or on any [statutory economic interest]." [Section 87103.]

Since the passage of the Act in 1974, the Commission has implemented this statutory conflict-of-interest rule by means of Commission regulations. The regulations have gone through a variety of piecemeal amendments over the years in order to clarify them or adapt them to new circumstances.

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[1] "Interested persons" meetings were held in December 1999, January and August 2000, and January, March and July of 2001. The Commission also considered the issue at the February, May and October 2000 Commission Meetings.

In 1998, the Commission embarked on the Conflict of Interest Regulations Improvement Project (the "project"). The project was intended to be a comprehensive review and amendment of the existing conflict regulations. Phase 1 of the project sought to reorganize the regulations to make them easier to use. This resulted in the development of the eight-step process. The first six steps essentially determine whether the conflict of interest exists. They are:

(1) Determine whether the individual is a public official, within the meaning of the Act. If the individual is not a public official, he or she does not have a conflict of interest within the meaning of the Political Reform Act.

(2) Determine whether the public official will be making, participating in making, or using or attempting to use his/her official position to influence a government decision.

(3) Identify the public official's economic interests.

(4) For each of the public official's economic interests, determine whether that interest is directly or indirectly involved in the governmental decision which the public official will be making, participating in making, or using or attempting to use his/her official position to influence.

(5) Determine the applicable materiality standard for each economic interest, based upon the degree of involvement determined pursuant to California Code of Regulations, title 2, section 18704.

(6) Determine whether it is reasonably foreseeable that the governmental decision will have a material financial effect on each economic interest identified pursuant to California Code of Regulations 18703. Regulation 18706 provides that "[A] material financial effect on an economic interest is reasonably foreseeable, within the meaning of Government Code section 87103, if it is substantially likely that one or more of the materiality standards (see Cal. Code Regs., tit. 2, §§ 18704, 18705) applicable to that economic interest will be met as a result of the governmental decision." A financial effect need not be a certainty to be considered reasonably foreseeable. On the other hand, if an effect is only a mere possibility, it is not reasonably foreseeable. (*In re Thorner* (1975) 1 FPPC Ops. 198.)

The last two steps are exceptions to the conflict-of-interest rules necessary only if the official determines that a conflict of interest exists.

(7) Determine if the reasonably foreseeable financial effect is distinguishable from the effect on the public generally.

(8) Determine if the public official's participation is legally required despite the conflict of interest.

Phase 2 included the substantive amendment to the regulations within this eight-step framework. These substantive amendments were adopted in December 2000 and were effective on February 1, 2001.

This memorandum pertains to the treatment of step (6) of the standard conflict-of-interest analysis, "is it reasonably foreseeable that the governmental decision will have a material financial effect on the economic interests of the official?"

III. FORESEEABILITY

Foreseeability has been a component part of a "conflict of interest" since the voters adopted the Political Reform Act in 1974. It is a necessary component. A conflict of interest will not exist if the material financial effect on an economic interest of the official is not reasonably foreseeable. However, foreseeability has always been a fact-based analysis. "[C]ases also make it clear that the question of whether financial consequences upon a business entity are reasonably foreseeable at the time a governmental decision is made must always depend on the facts of each particular case." (*In re Thorner, supra.*)

A regulatory definition of "foreseeability" as part of Phase 2 of the project was first requested in 1999. This issue arose in connection with the South San Francisco City Attorney's proposal that would have provided a "bright-line" standard for foreseeability applicable to real estate professionals. Real estate agents and brokers perceived that they are unfairly "singled out" by the conflict-of-interest laws. They felt they were disproportionately disqualified due to conflicts, especially in land-use decisions. The realtors' perceptions about these issues apparently came to a head with the issuing of the *Teasley* Advice Letters, Nos. 97-545, 97-545a. The Teasley letters are prominently mentioned in the South San Francisco City Attorney's written proposal, and were widely discussed in the working group meetings.

Ms. Teasley is a real estate agent who served on the Moorpark City Council. The City Council faced a vote on a massive development, which would more than double the amount of commercially zoned property in the jurisdiction and increase by almost half again the number of residential units in the jurisdiction. The project was phased over approximately fifteen years. Ms. Teasley originally inquired about conflicts if she pursued business opportunities in the proposed development, but in a subsequent request for advice renounced any personal intention to pursue such business opportunities. We advised Ms. Teasley that she had economic interests in her employer, a real estate brokerage, and in her own income from commissions, etc. We also advised that a development of that magnitude, even if phased over a long period of time, would have a reasonably foreseeable material financial effect on both of those economic interests, and that she thus had a conflict of interest.

Two aspects of the Teasley advice seem to frustrate the realtors (and others) particularly. First,

they seem to feel that Ms. Teasley's stated intentions to refrain from pursuing business were not given adequate weight[2]. Second, they are frustrated that a material financial effect, which is deferred for a long period of time, is still considered "reasonably foreseeable." The realtors proposed a strict time limit as a definition of "foreseeability." Effects that occurred outside the time limit were not considered foreseeable.

While a strict time limit on foreseeability has never before existed,[3] time has always been a factor to be considered in determining foreseeability. For example, in *In re Galligan* (2000) 14 FPPC Ops. 1, the Commission concluded that a financial effect was too speculative and subject to contingencies:

> "With regard to Councilmember Galligan's participation in the appeal before the city council of the planning commission's decision not to certify the EIR on 301 Airport Boulevard, the question of early repayment of the loan is too speculative and subject to contingencies for the Commission to determine that it is substantially likely to occur early enough to result in a material financial effect. Intervening factors, such as the possibility of lawsuits enjoining construction, alternative use proposals by Glenborough, and the independent and subjective decision by Glenborough to retire the loan early in any instance, make it impossible to say that a material financial effect is substantially likely."

This time/intervening contingency factor has been incorporated in the proposed language.

Staff has consistently recommended against a strict time limit. After Phase 2, such a limit appears even less necessary. Staff believes that the issue has been addressed through less sweeping changes to the Act's conflict-of-interest regulations.

The Commission has worked diligently to review and update the conflict-of-interest regulations in the Act during Phase 2, including the materiality regulations, the public generally regulations and other conflict-of-interest definitions and terms. For example, the public generally exception was clarified and new versions adopted during the Phase 2 process. This exception presumably applies more frequently and allows more officials to participate in decisions despite conflicts of interest. More importantly, the Commission adopted amendments to the materiality thresholds applicable to business entities, in many cases doubling these thresholds. Thus, for example, where a realtor formerly was disqualified whenever

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[2] However, a relevant factor in that letter was that the real estate brokerage (business) which was a source of income of hers would be doing business, therefore her intentions regarding her own activity did not affect the analysis regarding other economic interests of the official.

[3] One problem with such a rule is that even *absolutely certain* financial effects, if they will occur after the time limit, are not considered foreseeable.

there was a $10,000 effect on the gross revenues of his employer, he would now only be disqualified if the employer were affected by $20,000.[4] Finally, the statutory definition of economic interest has also been amended by legislation effective January 1, 2001, doubling the thresholds required before a public official is even considered to have an economic interest in decisions.

With respect to foreseeability, staff also made efforts to clarify this concept. In the *Olson* Advice Letter, No. A-00-237 (attached), we analyzed foreseeability in the context of real estate professionals.

The Olson letter was staff's effort to clarify the foreseeability analysis where the official (or his or her spouse) was a real estate professional and was confronted with decisions on development in the jurisdiction. In the letter, staff concluded that no conflict of interest existed in part due to the fact that neither the official nor the official's employer may sell homes from the development once completed, but would only be able to sell homes from the development when they are resold, if hired to do so. In addition, the jurisdiction was subject to mandatory growth limitations which required large developments to be phased in over a number of years. Thus, the likelihood of the financial effect reaching the applicable materiality threshold in the regulation was remote. After setting forth the standard analysis (set forth under step 6 above), we discussed the preeminent Commission Opinion on foreseeability, *In re Thorner*.[5]

> "[T]he question of whether financial consequences upon a business entity are reasonably foreseeable at the time a governmental decision is made must always depend on the facts of each particular case."

Thus, in the *Olson* Advice Letter, No. A-00-237, we identified factors out of the *Thorner* Opinion that should be considered in the determination of foreseeability:

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[4] Note that larger thresholds apply to larger businesses. These thresholds were also increased in December 2000.

[5] *Thorner* concerned directors of a municipal water district who held significant interests in business entities which could be affected by the district's decisions on requests for variances and the lifting of a moratorium on new water connections. The Commission concluded that the directors were required to disqualify themselves when the decisions would have a foreseeable material financial effect, distinguishable from their effect on the public generally, on the directors' interests. The Commission analyzed a variety of factual scenarios to determine whether a material financial effect was foreseeable. For example, the Commission compared a situation where a contractor who was a regular customer of the director's construction business (McPhail's) was preparing to bid on or had bid on a project that was the subject of the decision, to a similar situation where the contractor was already awarded the contract, but had not yet purchased or agreed to purchase any of the official's products for the project. The Commission concluded that in the latter scenario, the financial effect was reasonably foreseeable.

(1) The Historic Pattern of Business in the Jurisdiction.

(2) The Market Share and/or the Existence of Substantial Competition.

(3) Affirmative Acts on the Part of the Official to Take Advantage of the Financial Effects of the Decision.

(4) The Scope of the Governmental Decision.

(5) Intervening Contingencies.

Since the issuance of the *Olson* Advice Letter, in December 2000, two working group meetings were conducted. Consensus of interested persons was that the Olson factors were helpful in dealing with the foreseeability issues. Interested persons also perceived the difficulty in any bright line definition of foreseeability. Since foreseeability is a fact-based determination, setting out a static definition is virtually impossible. However, interested persons also agreed that codification of the *Olson* factors in a regulation would be useful since most city attorneys may not be aware of the letter itself and an advice letter does not constitute a formal Commission interpretation of the statute.

IV. Regulatory Language

The regulatory proposal by staff, agreed to in concept by interested persons, is simply the insertion of the Olson letter factors into existing regulation 18706. This is the first **decisionpoint.** Subdivision (a) sets forth the existing general rule. Subdivision (b) (**decisionpoint 1**) lists the Olson factors.

The only other decisionpoint for the Commission **(decisionpoint 2)** is whether the factors should be limited to the determination of foreseeability in the context of real estate professionals, or should be more generally applicable to all officials with business interests. The Commission may consider other approaches to limit the application of this analysis, other than that expressly set out in the regulation. For example, the Commission could limit the analysis to real property development decisions. Staff makes no recommendation on the scope of this exception. Staff believes the language is general enough to apply to many scenarios. On the other hand, the question was initially raised by real estate professionals and may be less of an issue beyond these persons who by profession deal in the sale of property.

Finally, subdivision (c) simply restates existing law that merely holding a real estate sales or

brokerage license does not in itself make a material financial effect on the official's economic interest reasonably foreseeable.[6]

Attachments:
Proposed Regulation 18706
Olson Advice Letter, No. A-00-237

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[6] This issue was raised in Assembly Bill 1838 (Ch. 352, Stats. 2000) which stated:

> "The Legislature finds and declares that it is necessary for the Fair Political Practices Commission to periodically review and improve the regulations that implement the Political Reform Act of 1974. It is the intent of the Legislature that, in order to prevent an unnecessary chilling of participation in the governmental and regulatory process by public officials of local government agencies, the Fair Political Practices Commission, as part of its Conflict of Interest Regulatory Improvement Project of 1999-2000, shall adopt regulations with respect to those officials that would accomplish all of the following:
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> "¶....¶
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> "Clarify that the fact that holding a professional license does not of itself give rise to a disqualifying conflict of interest."