BEFORE THE FAIR POLITICAL PRACTICES COMMISSION

In the Matter of: Opinion requested by Iris Sankey, Member, State Board of Equalization	No. 76-071 Nov. 3, 1976

BY THE COMMISSION: We have been asked the following questions by Iris Sankey, a member of the State Board of Equalization:

Iris Sankey and her husband have a 50 percent joint tenancy interest in real property located in Escondido, California which has a fair market value of $500,000. An office building of 10,000 square feet is located on this property and the property is leased to Pacific Telephone and Telegraph Company pursuant to a ten-year lease that expires in 1978. Pacific Telephone pays a monthly rental of $4,200 and has an option to renew the lease for an additional ten years at the same monthly rental rate. Under the terms of the lease agreement, there is no way to increase or decrease the monthly rental rate, either under the existing lease or under the renewed lease should Pacific Telephone opt to renew the lease. Also, under the terms of the lease agreement, the property tax assessment is made in the name of Pacific Telephone and the tax is paid directly to the county tax collector by Pacific Telephone.

Pursuant to the provisions of Section 19, Article XIII, of the California Constitution, the State Board of Equalization is required, annually, to assess property owned or used by a regulated telephone company. Since the above described property is used by Pacific Telephone, a regulated telephone company, the State Board of Equalization is required to assess it. Given these facts, Ms. Sankey asks:

(1) Must she, as a member of the State Board of Equalization, disqualify herself from participating in the assessment of the parcel of property in which she and her husband have a 50 percent equity interest and which is leased to Pacific Telephone?

(2) Must she disqualify herself from assessing any other property owned by Pacific Telephone?

CONCLUSIONS

(1) Ms. Sankey must disqualify herself from participating in the assessment of the parcel of property in which she and her husband have a 50 percent equity interest and which is leased to Pacific Telephone.

(2) Ms. Sankey also must disqualify herself from participating in the assessment of other property owned by Pacific Telephone.

ANALYSES

(1) Government Code Section 87100[1/] contains the basic conflict of interest prohibition and provides:

> No public official at any level of state or local government shall make, participate in the 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.

To be subject to the prohibition, all three stated requirements must be satisfied. One must be a public official; make, participate in making, or attempt to use one's official position to influence a governmental decision; and know or have reason to know that one has a financial interest in the governmental decision.

As a member of the California State Board of Equalization, a state agency within the meaning of Section 82049, Ms. Sankey clearly is a public official.[2/] Furthermore, by

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1/ All statutory references are to the Government Code unless otherwise noted.

2/ Section 82048 states that "public official" means "every member, officer, employee or consultant of a state or local government agency."

participating in Board discussion and debate, offering her opinion on matters before the Board, verbally presenting her analysis of issues, and voting, Ms. Sankey "makes, participates in making or attempts to use" her official position to influence governmental decisions within the meaning of Section 87100. See 2 Cal. Adm. Code Section 18700(b), (c) and (e). Finally, we think that Ms. Sankey also has a "financial interest" in the governmental decision concerning the assessment of the property leased to Pacific Telephone.

Government Code Section 87103 defines "financial interest":

> An 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:
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> (a) Any business entity in which the public official has a direct or indirect investment worth more than one thousand dollars ($1,000);
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> (b) Any real property in which the public official has a direct or indirect interest worth more than one thousand dollars ($1,000);
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> (c) Any source of income, other than loans by a commercial lending institution in the regular course of business, aggregating two hundred fifty dollars ($250) or more in value received by or promised to the public official within twelve months prior to the time when the decision is made; or
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> (d) Any business entity in which the public official is a director, officer, partner, trustee, employee, or holds any position of management.
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> For purposes of this section, indirect investment or interest means any investment or interest owned by the spouse or dependent child of a public official, by an agent on behalf of a public official, by any business entity controlled by the public official or by a trust in which he has a substantial interest. A business entity is controlled

> by a public official if the public official, his agents, spouse and dependent children hold more than fifty percent of the ownership interest in the entity. A public official has a substantial interest in a trust when the official, his spouse and dependent children have a present or future interest worth more than one thousand dollars ($1,000).

Ms. Sankey's 50 percent equity interest in real property with a fair market value of $500,000 clearly brings her within the provisions of Section 87103(b) dealing with interests in real property. In addition, receipt of her share of the $4,200 monthly rental from Pacific Telephone makes Pacific Telephone a source of income to Ms. Sankey within the meaning of Section 87103(c). The determinative issue, however, with respect to whether Ms. Sankey has a "financial interest" in the Board's assessment decision is whether it is reasonably foreseeable that the decision will have a material financial effect, which is distinguishable from its effect on the public generally, on her interest in the leased property or on Pacific Telephone, her source of income.

With respect to foreseeability, it seems clear that this criterion is satisfied both as to Ms. Sankey's interest in real property and her source of income. Real property is reassessed periodically to bring its assessed valuation into conformity with the fair market value of the property. It seems not only foreseeable but certain that a reassessment will have a financial effect on the real property reassessed by making it subject to increased or decreased taxes. As to Pacific Telephone, the source of income, it again is readily apparent that a reassessment decision will have a financial effect since under the terms of the lease the property tax assessment is made in the name of Pacific Telephone and the tax is paid directly to the county tax collector by Pacific Telephone. Under these circumstances, when the assessed valuation of the real property changes, the taxes for which Pacific Telephone is liable also will change.

Turning to whether the foreseeable financial effect will be "material," we must consider the potential impact of a decision on both Ms. Sankey's interest in real property and her source of income. 2 Cal. Adm. Code Section 18702 establishes a general test and specific guidelines for determining when the financial effect of a governmental decision is material. The general test provides:

> (a) The financial effect of a governmental decision on a financial interest of a public official is material if, at the time the official makes, participates in making or attempts to use his or her official position to influence the making of the decision, in light of all the circumstances and facts known at the time of the decision, the official knows or has reason to know that the existence of the financial interest might interfere with the official's performance of his or her duties in an impartial manner free from bias.

Ms. Sankey has a substantial interest in the real property being assessed. If she paid the taxes under the terms of the lease, or if the property were not leased, her direct tax liability on this real property interest might well interfere with an impartial rendering of an assessment decision. Currently, Ms. Sankey is one step removed from tax liability because Pacific Telephone pays the taxes directly. Nevertheless, in assessing whether her interest in the real property might interfere with her impartiality, we do not think this is determinative.

In addition, Pacific Telephone has an option to renew the lease agreement to which Ms. Sankey is a party for an additional ten-year period at the same rental rate. If this lease agreement is favorable to Ms. Sankey, presumably she would like the lease renewed for an additional ten-year period to maintain this source of income; and the decision by Pacific Telephone to renew might well be influenced by favorable tax assessment treatment. Conversely, the income received under the lease agreement might be unsatisfactory to Ms. Sankey, in which case an assessment that substantially increased taxes for which Pacific Telephone is liable might induce Pacific Telephone not to renew the lease.

Given these facts and circumstances, we believe that a reasonable person would conclude that the existence of either or both of Ms. Sankey's financial interests might interfere with the impartial performance of her assessment duties. Accordingly, the financial effect of an assessment decision

concerning the property leased to Pacific Telephone will be "material" within the meaning of 2 Cal. Adm. Code Section 18702(a).[3/]

Finally, it also is readily apparent that the financial effect of an assessment decision on the Escondido property leased to Pacific Telephone will be distinguishable from its effect on the public generally. Each parcel of property is unique and independently assessed. Hence, the financial effect of an assessment decision varies from property to property, and the effect on any given property generally is distinguishable from the effect on any other piece of property. Moreover, to the extent the financial effect of an assessment decision on the Escondido property clearly is distinguishable from its effect on the public generally, it follows that the financial effect of the assessment decision on Ms. Sankey's source of income, Pacific Telephone, also is distinguishable from its effect on the public generally. Thus, in response to Ms. Sankey's first question, we conclude that she must disqualify herself from participating in the assessment of the parcel of property in which she and her husband have a 50 percent equity interest and which is leased to Pacific Telephone.

(2) We turn now to the second question raised in this opinion request, whether Ms. Sankey must disqualify herself from assessing any other property owned by Pacific Telephone. In our review of Ms. Sankey's first question, we determined that she is a public official and that she makes, participates in making and attempts to use her official position to influence governmental decisions. Accordingly, with respect to the second question, the only issue is whether she has the requisite "financial interest."

We observe at the outset that because Ms. Sankey has no real property interest in property owned by Pacific Telephone, the requisite "financial interest" can be based only on the fact that Pacific Telephone is a "source of income" to Ms. Sankey within the meaning of Section 87103(c). We also note that our

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3/ Having concluded, under the general test set forth in 2 Cal. Adm. Code Section 18702(a), that the existence of Ms. Sankey's financial interests might interfere with the performance of her duties in an impartial manner, we find it unnecessary to consider the more specific guidelines set forth in 2 Cal. Adm. Code Section 18702(b)(2) and (3).

earlier analysis with respect to foreseeability is equally applicable here. Property is periodically reassessed to generate additional tax revenues by bringing assessed valuation into conformity with the fair market value of the property and it, therefore, is certain that an assessment decision on property owned by Pacific Telephone will have a financial effect on the company.

The decisive inquiry is whether this financial effect will be material within the meaning of Section 87103. In our analysis of whether Ms. Sankey can participate in assessment decisions concerning the property she leases to Pacific Telephone we relied on the general test used to determine materiality. 2 Cal. Adm. Code Section 18702(a). There also are specific guidelines which are relevant to a determination of whether a financial effect on a source of income will be material. These provide that:

> (b) In determining the existence of a material effect upon a financial interest, consideration should be given, but not be limited to, an analysis of the following factors:
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> ...
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> (3) In the case of a source of income of a public official as defined in Government Code Section 87103(c):
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> (A) The decision will affect the source of income in the manner described in subsection (b)(1) above;
>
> (B) Whether the governmental decision will directly affect the amount of income to be received by the official;
>
> (C) Whether there is a nexus between the governmental decision and the purpose for which the official receives income.

2 Cal. Adm. Code Section 18702(b)(1), referred to in subsection (b)(3)(A) above, provides:

> (1) In the case of a business entity in which the public official has a direct or indirect investment worth more than one thousand dollars ($1,000), or in the case of a public official who is a director, officer, partner, trustee, employee, or holds any position of management in a business entity:
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> > (A) Whether the effect of the decision will be to increase or decrease the annualized gross revenue of the business entity by one percent or more or the annual net income of the business entity by .5 percent or more;
> >
> > (B) Whether the effect of the decision will be to increase or decrease the assets or liabilities of the business entity by $50,000 or more, or by .5 percent of its current assets or liabilities, whichever is less.

In deciding whether Ms. Sankey can participate in assessment decisions concerning property owned by Pacific Telephone, these specific guidelines are particularly relevant. It will be helpful, however, to recount some general facts about the Board of Equalization's assessment practices and Pacific Telephone before applying the guidelines.

The State Board of Equalization does not individually value the various component parts of property owned by a public utility such as Pacific Telephone. Rather, the Board's valuations are unit appraisals of integrated properties as a whole; and properties appraised using the unit valuation principle are called "unitary" properties. In 1975, the State Board of Equalization valued Pacific Telephone's unitary properties in California at $6.1 billion. In 1976, the Board revised the market value of Pacific Telephone's California properties to $6.9 billion.[4/] This reflects an $800 million increase in the value of Pacific Telephone's California properties between

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4/ These figures, and others referred to herein, were provided by representatives of the State Board of Equalization.

1975 and 1976.[5] Because unitary properties have been assessed at 25 percent of their market value since 1973, the Board's 1976 unitary properties valuation increased the assessed value of Pacific Telephone's California properties by $200 million.[6]

In 1975, the average tax rate in California was $11.24 per $100 of assessed valuation. Of course, the actual rate varied from district to district. However, if we apply the 1975 average tax rate to the $200 million increased assessment for Pacific Telephone, the Board's unitary properties assessment decision increased Pacific Telephone's taxes by approximately $22.5 million for 1976. In 1975, Pacific Telephone's net income was $310,946,000.

Applying the specific guidelines of 2 Cal. Adm. Code Section 18702(b)(3) to these facts, it is clear that the quantitative standard of materiality set forth in subsection (b)(3)(A) is applicable. If Pacific Telephone is able to pass on to its customers only $21 million or less of its additional tax liability of approximately $22.5 million, the Board's assessment decision will decrease the Company's annual net income by .5 percent or more (assuming that 1976 income is comparable to that earned in 1975). Also, the approximately $22.5 million in increased taxes which Pacific Telephone had to pay as a result of the

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[5] This increase, although substantial, is not atypical when compared to other increases as reflected in other Board decisions of recent years. During the five years previous to 1976, the Board's decisions reflected increases in the fair market value of Pacific Telephone's unitary properties of $304 million (1975), $236 million (1974), $444 million (1973), $516 million (1972) and $270 million (1971).

[6] Based on the assessment rates in effect in other years, the increases in fair market value resulted in the following increases in assessed valuation during the five years previous to 1976: $76 million in 1975; $59 million in 1974; $111 million in 1973; $139 million in 1972; and $78 million in 1971.

Board's assessment decision far exceeds the $50,000 in decreased assets or increased liabilities specified in 2 Cal. Adm. Code Section 18702(b)(1)(B).[7]

Under these circumstances, we conclude that the requisite material financial effect is present and that Ms. Sankey, therefore, must disqualify herself from making, participating in making or using her official position to influence assessment decisions of the Board of Equalization concerning Pacific Telephone's property.[8] We realize the specific guidelines enumerated in 2 Cal. Adm. Code Section 18702(b) are not absolutes which necessarily require disqualification when they are present. We also are cognizant of the fact that subsections (B) and (C) of 2 Cal. Adm. Code Section 18702(b)(3) are not present in Ms. Sankey's situation. In particular, the Board's assessment decisions "will [not] directly affect the amount of income to be received," 2 Cal. Adm. Code Section 18702(b)(3)(B), by Ms. Sankey pursuant to the lease agreement with Pacific Telephone since that amount is fixed under the agreement, nor is there any apparent nexus between assessment decisions and the purpose for which Ms. Sankey receives the rental income, 2 Cal. Adm. Code Section 18701(b)(3)(C). We think, however, that any reasonable standard of materiality necessarily must encompass governmental decisions which have the type of multi-million dollar tax impact that Board assessment decisions have on Pacific Telephone.

7/ The regulation speaks in terms of an increase or decrease in a business entity's assets or liabilities by $50,000 or more, or by .5 percent of its "current assets or liabilities, whichever is less." Although we do not know precisely what Pacific Telephone's current assets and liabilities were at the time of the Board's assessment decision, the company had assets of approximately $8.2 billion and liabilities of approximately $4 billion on December 31, 1975. The $50,000 figure, therefore, undoubtedly represents a lesser figure than .5 percent of the company's current assets and liabilities at the time the assessment decision was made and is the operative amount in applying 2 Cal. Adm. Code Section 18702(b)(3).

8/ The assessment decision obviously has a financial effect on Pacific Telephone which is distinguishable from its effect on the public generally. See text, <u>supra</u> at 9.

Of course, we recognize, too, that the $22.5 million figure referred to herein reflects the impact of decisions which already have been made and that in this opinion we are concerned with whether Ms. Sankey must disqualify herself with respect to future assessment decisions of the Board. The requisite material financial effect, however, need only be "reasonably foreseeable" and we think that recent experience is both particularly pertinent and instructive in this respect in the present case. It unquestionably demonstrates that an expectation that the next assessment decision of the Board will have a material financial effect on Pacific Telephone is warranted.

Approved by the Commission on November 3, 1976.
Concurring: Brosnahan, Carpenter, Lowenstein and Quinn.
Abstaining: Lapan.

Daniel H. Lowenstein
Chairman