BEFORE THE FAIR POLITICAL PRACTICES COMMISSION

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| In the Matter of:<br><br>Opinion requested by Tom Thorner, on behalf of the Board of Directors, Marin Municipal Water District | No. 75-089<br>December 4, 1975 |

BY THE COMMISSION: We have been asked the following questions by Tom Thorner on behalf of Directors Jack MacPhail and Pamela Lloyd of the Board of Directors of the Marin Municipal Water District (hereinafter "MMWD"):

(1) May directors of a municipal water district holding interests in business entities which may be affected by the district's decision in response to requests for variances from a moratorium on new water connections participate, under the circumstances described below, in the decisions on those requests?

(2) May these same directors participate in discussions of the Board of Directors on the feasibility of lifting the moratorium, or vote on the lifting of the moratorium?

The relevant facts, as set forth in Mr. Thorner's opinion request, are as follows:

The Marin Municipal Water District is a municipal water district with a governing board of five directors. It presently has an existing moratorium on new water connections. The Board of Directors is required, from time to time, to hear and to rule on two different types of requests for variances from the moratorium:

(a) Requests for new water connections;

(b) Requests for extensions of the certificate of occupancy deadlines for grand-fathered services subject to buildout deadlines, but otherwise exempt from the moratorium.

The Board also hopes to begin discussions in the near future on when, how and on what basis the moratorium can be lifted,

which discussions are expected to lead eventually to a vote on whether the moratorium should be lifted and, if so, when.

Director Jack MacPhail is the executive vice-president, a salaried employee and a minority stockholder of McPhail's, Inc., a closely held family corporation. He and his family control 50 percent of the outstanding stock in the corporation.

McPhail's does business almost entirely within Sonoma and Marin Counties, and does over half of its business within the MMWD. It has gross sales of between $5,000,000 and $10 000,000 annually, and earns an annual after-tax profit of less than two percent on sales. The business of McPhail's consists of: (a) the sale of ready-mix concrete and building materials, such as bulk aggregates, rebar steel, cast patio materials, decorator rock, and sacked materials (sand, cement, lime, concrete mix, vermiculite, etc.), both to contractors and at retail; (b) the sale of major appliances, such as washers, dryers, dish-washers, stoves, refrigerators, television sets, etc., both to builder-jobbers and at retail; (c) the sale of fuels, propane, heating oil and road oil, principally at retail; and (d) the sale of heating, air conditioning and sheet metal products, both at wholesale and at retail.

McPhail's has numerous competitors in all of these areas, except ready-mix concrete, where it has only three major competitors. Its estimated relative market share within the MMWD of the foregoing products is: ready-mix concrete -- less than 33-1/3 percent; building materials -- less than 25 percent; major appliances -- less than 20 percent; fuels -- over 50 percent of bottled gas, but less than two percent of the total market since most homes are served natural gas by Pacific Gas and Electric; heating, air conditioning and sheet metal products -- less than five percent.

Whenever an applicant for water for any project comes before the Board of Directors of the MMWD, Mr. MacPhail may be facing one of the following situations:

(a) McPhail's has no known connection with the project, but may later bid on or supply to the project ready-mix, building materials, appliances and/or fuel;

(b) McPhail's is preparing or has made a bid to supply one or more of its products, but no award has been made;

(c) A contractor, who is a regular customer of McPhail's and who normally buys principally

or only from McPhail's, is preparing to bid or has bid on the project and, if awarded the contract, probably will purchase some of McPhail's products for the job;

(d) The type of contractor described in (c) already has been awarded the contract but has not yet purchased or agreed to purchase any of McPhail's products for the project;

(e) McPhail's is supplying some of its products to the project, but the dollar value of the products supplied compared to McPhail's total sales may be small.

Mr. Thorner also has indicated that the MMWD is almost totally residential and that "probably 95% of these applications for variances are for single-family homes and most of the rest are for apartments." (Hearings before the Fair Political Practices Commission, October 2, 1975, transcript at p. 142.)

On the moratorium question, a vote to lift the moratorium would probably increase building activity within the MMWD and, therefore, would result in a substantial economic benefit to McPhail's. However, there will be no foreseeable special benefit to McPhail's in relation to its competitors.

Director Lloyd's husband is employed by Dinwiddie Construction Company as a project engineer. Dinwiddie is a private, closely held corporation specializing in the construction of large commercial structures ($1,000,000 and up) in the San Francisco Bay area and the Los Angeles Metropolitan area. Its gross volume runs between $40,000,000 and $80,000,000 yearly and it has been consistently profitable.

At the present time, Dinwiddie is completing construction of the Fireman's Fund Building, the largest building within the MMWD. Dinwiddie obtained this job by virtue of its low bid in competitive bidding. Dinwiddie's only other jobs within the MMWD were about ten years ago, when it built an Emporium Department Store and a Crocker Bank Building in San Rafael. In both cases, the clients were regular customers of Dinwiddie and the contracts were negotiated. The Fireman's Fund Building has water service, will not need a variance from the moratorium on new water connections, and its construction will not be affected by any action of the MMWD relative to continuing or lifting the moratorium. Moreover, Dinwiddie is neither preparing to bid on nor negotiating for, any contract for any construction within the MMWD, nor is it aware of any proposed project within the MMWD on which it contemplates bidding or negotiating. It is, of course, possible that in the future Dinwiddie may wish to bid on or negotiate for a contract for construction within the MMWD.

Director Lloyd's husband is assigned as project engineer on the construction of the Bank of America Data Center in San Francisco (which is not within the MMWD) and expects to be employed in that capacity at that site until 1978. He is paid on a straight salary basis and would not receive any additional compensation if Dinwiddie were to obtain a new contract within the MMWD.

## CONCLUSION

(1) Directors of a municipal water district holding significant interests in business entities which may be affected by the district's decisions on requests for variances from a moratorium on new water connections may not participate in the decisions on those requests when the decisions will have a reasonably foreseeable material financial effect on the business entities in which the directors hold significant interests. Government Code Section 87100.

(2) Directors of a municipal water district who have significant interests in business entities which may be affected by a decision lifting a moratorium on new water connections may not participate in discussions of the Board of Directors on the feasibility of lifting the moratorium, nor vote on the lifting of the moratorium, when the decision to lift the moratorium will have a reasonably foreseeable material financial effect, distinguishable from the effect on the public generally, on the business entities in which the directors hold significant interests Government Code Section 87100.

## ANALYSIS

We consider first the question of Director MacPhail's participation on requests for variances in the situations described in examples (a) through (e), supra, at pp. 2-3. The pertinent sections of the Political Reform Act provide:

> 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.
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> Government Code Section 87100.[1]

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

> 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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> Section 87103
> (Emphasis added).

Under the foregoing sections, several elements must be present before a public official is required to disqualify himself from participation in a governmental decision. First, it must be reasonably foreseeable that the governmental decision will have a financial effect. Second, the anticipated financial effect must be on a financial interest of the official, as defined in Sections 87103(a) through (d). Third, the anticipated financial effect must be material And fourth, the governmental decision's anticipated financial effect on the official's financial interest must be distinguishable from its effect on the public generally

There can be no doubt but that Director MacPhail has a financial interest in McPhail's, Inc., within the meaning of Section 87103, since it is a business entity in which he has a direct investment worth more than $1,000 and it also is a source of income of more than $250 per year. Nor can there be any serious doubt that if McPhail's, Inc. becomes a supplier to any project which is made possible by the granting of a variance, the effect of the variance on McPhail's, Inc. will be distinguishable from the effect on the public generally. Although there may be many suppliers to a particular building project, they cannot constitute a large enough group to qualify as the "public generally," or even a significant segment of the public generally. Accordingly, the only elements in question with respect to Director MacPhail's participation in variance decisions are foreseeability and materiality In any instance in which these two elements are present to the extent required by the Act, Director MacPhail must disqualify himself from participation in the decision.

We may quickly dispose of the element of materiality. In examples (a) through (d), we are given no information about the quantity of business which will accrue to McPhail's, but only information related to the likelihood that McPhail's will receive some business. These examples clearly are intended to elicit our interpretation of the element of foreseeability and we assume, in the discussion that follows, that the amount of business that McPhail's, Inc. may or may not receive is "material."

Example (e), on the other hand, appears to be directed at the element of materiality rather than foreseeability. McPhail's, Inc. certainly will receive business, conditional upon the granting of the variance, under the circumstances posited in example (e), but the total sales "may not be such as to have a 'material economic effect' on McPhail's, depending upon how that phrase is interpreted." Since, however, we have not been provided with facts upon which we could base a judgment regarding the element of materiality, we decline to address this issue in this opinion.

We turn, therefore, to the question of foreseeability in the specific context of Director MacPhail's participation in decisions on variances under the circumstances described in examples (a) through (d). We begin with consideration of the pertinent case law.

In the Dixon-Yates case, United States v. Mississippi Valley Generating Company, 364 U.S. 520 (1961), the Supreme Court voided a government contract because of the conflict of interest of an unpaid, intermittent, federal financial consultant who participated in the negotiations concerning the contract's provisions. Although the penal statute under which the contract was voided did not specifically require a finding of foreseeability,2/ the Court construed the statute as if the concept were specifically included within the statutory language.

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2/ 18 U.S.C. § 434, repealed Sec. 4, Pub. L. 87-849, October 23, 1962, 76 Stat. 1119, 18 U.S.C. § 201 (1969) provided:

> INTERESTED PERSONS ACTING AS GOVERNMENT AGENTS
> Whoever, being an officer, agent or member of, or directly or indirectly interested in the pecuniary profits or contracts of any corporation, joint-stock company, or association, or of any firm or partnership, or other business entity, is employed or acts as an officer or agent of the United States for the transaction of business with such business entity, shall be fined not more than $2,000 or imprisoned not more than two years, or both.

The financial consultant in question, Adolphe H. Wenzell, participated intimately on behalf of the federal government in negotiations leading to an agreement between various corporations to sponsor an electric power project which would provide electricity to the Atomic Energy Commission. Soon after Wenzell terminated his consultantship, a bank of which he was an officer contracted to finance the project. The Court described the foreseeable benefit or interest to Wenzell's bank, occasioned by his participation in the negotiations for the establishment of the project, in the following terms:

> ... Wenzell was an officer and executive of the First Boston; he not only shared in the profits which First Boston made during the year, but he also received a bonus for any business which he brought to the firm; <u>if</u> a contract between the Government and the sponsors was ultimately agreed upon, there was a <u>substantial probability</u> that, because of its prior experience in the area of private power financing, First Boston would be hired to secure the financing for the proposed Memphis project; if First Boston did receive the contract, it <u>might</u> not only profit directly from that contract, but it would also achieve great prestige and would thereby <u>be likely</u> to receive other business of the same kind in the future; therefore, Wenzell, as an officer and profit-sharer of First Boston, could expect to benefit from any agreement that might be made between the Government and the sponsors.
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> <u>United States v. Mississippi Valley Generating Company</u>, 364 U.S. 520, 555 (1961)
> (Emphasis added).

In response to Mr. Wenzell's argument that he could not be expected to benefit from the contract because there was no formal contract or understanding between his bank and the sponsors of the project with respect to financing the project should the sponsors enter into an agreement with the Government, the Court reasoned that:

> ... we do not think that the absence of such a formal agreement or understanding is determinative. The question is not whether Wenzell was certain to benefit from the contract, but whether the <u>likelihood</u> that he

> might benefit was so great that he would be subject to those temptations which the statute seeks to avoid.3/

Id. at 560 (Emphasis added).

Similar reasoning has supported a finding of foreseeable financial consequences of official action in several California conflict of interest cases.4/ These cases 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.

Against this background, we turn to the consideration of the reasonably foreseeable financial consequences of Director MacPhail's participation in examples (a) through (d). Each example presents a situation in which the district's decision on whether to grant a variance will permit a particular building to be constructed.

supply bidder

In example (a), Director MacPhail has no known connection with the project, although McPhail's, Inc. later may bid on or supply to the project certain materials. On these facts alone, we cannot find a reasonably foreseeable financial effect on McPhail's. McPhail's has numerous competitors in each product it sells, except ready-mix concrete (for which there are three major competitors). The situation is unlike that of United States v. Mississippi Valley Generating Company, supra, where "there was a substantial probability that, because of its

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3/ Justice Harlan, dissenting in Mississippi Valley, supra, reasoned that the "probability" of First Boston's sharing in the venture because of its reputation, derived from the financing of similar projects, was not enough to produce in Wenzell a prohibited interest in the negotiations.

> Whether or not a prohibited interest exists must be determined as of the period during which an individual is acting for the Government. And when the asserted interest arises "indirectly" by way of a subcontract, its existence can, in my opinion, only be found in some commitment, arrangement, or understanding obtaining at that time between the prime contractor and subcontractor.

364 U.S. at 569. Accord, Escondido Lumber Co. v. Baldwin, 2 Cal.App. [illegible] (19[illegible]

4/ See People v. Deysher, 2 Cal.2d 141 (1934); People v. Darby, 114 Cal.App.2d 412 (1952); Stockton Plumbing and Supply Co. v. Wheeler, 68 Cal.App. 592 (1971).

prior experience in the area of private power financing, First Boston would be hired to secure the financing...." 364 U.S. at 555. Therefore, a material financial effect upon McPhail's, Inc. is not reasonably foreseeable and Director MacPhail's participation in the decision whether to grant a variance is not prohibited.

In example (b), McPhail's is preparing or has made a bid to supply one or more of its products, but no award has yet been made. It is possible, of course, that there could be special circumstances present which would indicate that there is only a remote likelihood of McPhail's being awarded a supply contract. For example, McPhail's might have a reason for making a bid even though it is clear the contract will be awarded elsewhere. Under such circumstances, no financial effect on McPhail's would be reasonably foreseeable and Director MacPhail would not be disqualified from participation in the variance decision.

As a general rule, however, when the bid is made with a serious hope that the contract will be awarded to McPhail's, we think a financial effect on McPhail's is reasonably foreseeable even if there is substantial competition. The statute requires foreseeability, not certainty. Furthermore, the fact that a seriously competitive bid on the project is being prepared or has been made is likely to focus the attention of the Director on the fact that he may benefit if a variance is granted. The ultimate test is whether the element of foreseeability, together with the other elements discussed earlier, is present to the point that the official's "unqualified devotion to his public duty" might be impaired. People v. Darby, 114 Cal. App.2d 412, 433 (1952). Under the circumstances described in example (b), we conclude that the financial effect on McPhail's is reasonably foreseeable and that Director MacPhail, therefore, must not vote or participate in the variance decision.

In example (c), we are told that a contractor who is a regular customer of McPhail's and who normally buys principally or only from McPhail's, is preparing to bid on or has bid on the project and, if awarded the contract, probably will purchase some of McPhail's products for the job. In example (d), we are told that such a contractor already has been awarded the contract but has not yet purchased or agreed to purchase any of McPhail's products for the project.

There is a significant difference between the two situations. In example (d), although there is no certainty that McPhail's will receive business, there is a high probability that it will since the contractor who has been awarded the contract is a regular customer. Although there is no agreement, express or implied, cf. People v. Deysher, 2 Cal.2d 141 (1934), between McPhail's and the contractor, there is,

without question, a sufficient likelihood that McPhail's will receive business to make the financial effect on Director MacPhail "reasonably foreseeable."

In example (c), on the other hand, an extra degree of remoteness is added to the foreseeability of the financial effect by reason of the fact that the contractor has not yet been awarded the contract, but merely has entered a bid or is preparing to do so. McPhail's will benefit only if the contractor's bid is successful and the contractor follows its normal practice of purchasing from McPhail's.

In the case of a contractor who in the past has purchased only from McPhail's, Inc., it is reasonably foreseeable that Director MacPhail's decision could have a material financial effect upon McPhail's, Inc. However, where the contractor-applicant purchases from vendors other than McPhail's, Inc. we cannot conclude that a financial effect on McPhail's is reasonably foreseeable. Nevertheless, if in this latter example there are facts indicating that the contractor's bid is likely to be successful, the financial effect would be reasonably foreseeable since the situation then becomes analogous to example (d). In the last analysis what is reasonably foreseeable must depend on the facts and circumstances of each specific situation.

We turn next to consideration of whether Directors MacPhail and Lloyd may participate in discussions concerning lifting the moratorium and whether they may vote on this issue It is not questioned that building activity within the MMWD would increase as a result of a decision to lift the moratorium. This increase in building activity would provide significant opportunities for McPhail's to increase its sales within the MMWD. Moreover, the likely financial effect on McPhail's, Inc. would be both material and reasonably foreseeable. The only substantial question presented with respect to Director MacPhail is whether the financial effect on McPhail's resulting from lifting the moratorium would be "distinguishable from the effect on the public generally." Section 87103.

Generally, the decision on lifting the moratorium will have a financial effect upon a host of interests within the MMWD in the sense that most business entities, investments in real property, and thus sources of income, will be affected. The financial effect, however, of the decision upon McPhail's, and, therefore, upon the financial interest of Director MacPhail, are distinguishable from the financial effect of the decision on business entities, investments in real property and sources of income within the district in general.

Presently, McPhail's supplies approximately 33-1/3 percent of all ready-mix concrete, approximately 25 percent of all building materials, approximately 20 percent of all

major appliances, and over 50 percent of the bottled gas marketed within the MMWD. Thus, it is clear that the foreseeable financial impact upon McPhail's, Inc. of a decision to permit, in effect, an increase in building activity within the county differs demonstrably from the decision's financial impact upon virtually all other business entities and persons within the MMWD. Business entities and persons in the district may benefit in a general way since some property values may increase, retail sales may increase or employment and investment opportunities may increase. McPhail's, Inc., however, is in a position to realize immediate, substantial and specific financial gains as a result of renewed building activity.

Accordingly, we conclude, based on the facts presented, that Director MacPhail's financial interests in McPhail's, Inc. would be materially affected by a decision to lift the moratorium and that the financial effect of such a decision upon McPhail's would be distinguishable from its effect on the public generally. It follows that Director MacPhail may not participate in the decision or the discussions preceding the decision to lift the moratorium.

Director Lloyd has an interest in a source of income of $250 or more (Section 87103(c)) in that she has a community property interest in her husband's salary from Dinwiddie Construction Company. See Section 82030(a). The lifting of the moratorium would make it possible for large projects of the type in which Dinwiddie specializes to be constructed in the MMWD. If Dinwiddie, in fact, were to win the contract to construct such a project, it could be concluded that the lifting of the moratorium had a financial effect on Dinwiddie.5/ However, the likelihood of such an occurrence in the near future does not seem high since Dinwiddie has constructed only one project in the MMWD in the past ten years. Furthermore, such a financial effect would not necessarily be "material." Even a substantial project within the MMWD might constitute a small percentage of Dinwiddie's total revenues and have little impact on Dinwiddie's profits or net asset value. Nor would any benefit to Dinwiddie necessarily bear any relation to Director Lloyd's income from Dinwiddie, a factor we believe may be considered in determining whether there may be a material financial effect on a source of income. We are told that Director Lloyd's husband works and will work through 1978 on a project located outside the MMWD. He is paid on a straight salary basis and his compensation would not be affected by Dinwiddie's obtaining or failing

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5/ Such a conclusion would not be inevitable, however, since it is possible that a developer who is unable to build in the District because of the moratorium would build elsewhere in the San Francisco Bay Area, and that Dinwiddie's chances of winning the contract would be no different.

to obtain new contracts in the MMWD.

Under the foregoing circumstances, although it is conceivable that lifting the moratorium will have a material financial effect on Director Lloyd's source of income, we do not believe such an effect is reasonably foreseeable. Accordingly, Director Lloyd is under no restrictions with respect to voting or otherwise participating in the decision.

Approved by the Commission on December 4, 1975. Concurring: Brosnahan, Carpenter, Lowenstein and Lillie. Commissioner Waters was absent.

Daniel H. Lowenstein
Chairman