



FAIR POLITICAL PRACTICES COMMISSION

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May 26, 2000

Steve A. Perez
Second District Supervisor,
County of Kern
1115 Truxtun Avenue, Fifth Floor
Bakersfield, California 93301-4639

**Re: Your Request for Advice
Our File No. A-00-061**

Dear Mr. Perez:

This letter responds to your request for advice about the Political Reform Act (the "Act").¹ Since you have not asked about a specific purchase, we are treating your request as one for informal assistance. (Regulation 18329(b)(2)(B).) Informal assistance does not provide the immunity conferred by formal written advice. (Regulation 18329(c)(3).)

QUESTION

You have an investment interest in an e-company that is creating a web service for governmental agencies to purchase goods and services. You will not vote in the county's initial decision to use the web service. May you vote to approve purchases made by the county using the web service, after the county has already decided to subscribe to the service?

CONCLUSION

If you find that a particular purchase will increase the company's gross revenues by an amount specified in this letter, or have some other material financial effect on the company, you will be disqualified from approving that purchase.

¹ Government Code sections 81000 - 91015. Commission regulations appear at title 2, sections 18109 - 18996, of the California Code of Regulations.

FACTS

You are the Second District Supervisor for the County of Kern. In your private capacity, you will be serving as a member of an advisory board for a start up company that will be involved in e-commerce activities. The e-business intends to create a web site that will allow government agencies and nonprofit groups to purchase goods and services on the Internet. In exchange for your services on the advisory board, you will be receiving stock options with the company. The value of these stock options would likely exceed \$1,000.

The e-company is in beta test phase, which means it has selected specific governmental entities and businesses to test the system. Once the testing is complete, the web site will allow governmental entities to find vendors of a particular product, and obtain the lowest cost for the product. The purchasers will be able to use the web service at no cost. The vendors, however, would pay a fee to the e-company, either as a percentage of sales or for listing the vendor's services on the web site. Purchasers would pay the vendor directly for the goods or services.

The e-company may approach Kern County to subscribe to its service. The county has a purchasing agent, who purchases goods and services for the county. The board of supervisors, however, must approve purchases made by the purchasing agent when they exceed prescribed dollar amounts. You anticipate that for each purchase, the county's purchasing agent would issue a traditional RFP and place an RFP on the web site.

The e-company is a close corporation that you believe is worth approximately \$110 million, and has \$35 million in venture capital from major venture capital firms. You also believe the e-company probably meets the financial standards for listing on NASDAQ, and might even qualify for listing on the New York Stock Exchange. The e-company is based in San Francisco, and does not own real property in Kern County. In addition, you expect that the companies selling their products on the web site will not be in Kern County.

You intend to abstain from any decision regarding the county's use of the web site. However, where purchases are made through the web site, you would like to know whether your investment interest precludes your participation in any board approval of those purchases.

ANALYSIS

A. Conflict-of-Interest Prohibition

A public official may not make, participate in making, or in any way attempt to use his or her official position to influence a governmental decision in which the official knows, or has reason to know, that he or she has a financial interest. (Section 87100.) The Commission has developed an eight-step approach for determining whether an individual has a disqualifying financial interest in a decision. (Regulation 18700(b).)

1. Public Official

The conflict-of-interest prohibition only applies to public officials. (Section 87100.) As a county supervisor, you are a “public official” subject to the prohibition. (Section 82048.)

2. Conduct Covered

The prohibition covers specific conduct: making, participating in making, or attempting to use one’s official position to influence a governmental decision. These terms are defined in Regulations 18702-18702.4. By approving the purchases of goods and services made by the county, you will be engaging in conduct regulated by the conflict-of-interest prohibition. (Regulation 18702.1(a)(1).)

3. Economic Interest

A public official has a disqualifying 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,² or on the following enumerated economic interests:

1. Any business entity in which the official has a direct or indirect investment worth \$1,000 or more.
2. Any real property in which the official has a direct or indirect interest worth \$1,000 or more.
3. Any source of income of \$250 or more provided to, received by, or promised to the official within 12 months before the decision.
4. Any business entity in which the official is a director, officer, partner, trustee, employee, or holds any position of management.
5. Any donor of gifts worth \$300 or more provided to the official within 12 months before the decision. (Section 87103.)

In exchange for your services on the e-company’s advisory board, you will be receiving stock options with the corporation. The value of these stock options would likely exceed \$1,000. Section 82034 defines the term “investment,” in pertinent part, as:

“[A]ny financial interest in or security issued by a business entity ... if the business entity or any parent, subsidiary or

² A decision will have a financial effect “on the official,” within the meaning of Section 87103, if the decision will affect the official’s personal expenses, income, assets, or liabilities, or those of his or her immediate family. (Regulation 18703.5.) This is known as the “personal financial effect” rule. A financial effect on a public official’s personal finances based on his or her investment interest in a business entity does not trigger the personal financial effect rule. (*Ibid.*)

otherwise related business entity³ has an interest in real property in the jurisdiction, or *does business or plans to do business in the jurisdiction*, or has done business within the jurisdiction at any time during the two years prior to the time any statement or other action is required under this title.” (Emphasis added.)

Thus, under Section 82034, if the e-company does not “do business or plan to do business” in your jurisdiction, then the stocks that you hold in the company will not be considered an “investment” interest subject to the conflict-of-interest prohibition. Your jurisdiction as county supervisor is Kern County. At issue is whether the e-company “does business” or “plans to do business” in Kern County. The e-company is based in San Francisco, and it does not own real property in Kern County. The e-company plans to solicit its services to the county, but it will receive its income from the vendor, not the county. You expect that none of the vendors will be from Kern County.

The Act does not define “doing business.”⁴ However the Commission considered the meaning of “doing business” in the formal opinion, *In re Baty* (1979) 5 FPPC Ops. 10. In that opinion, the Commission held that an entity is doing business in an official’s jurisdiction if it has “business contacts” within the jurisdiction. Applying *Baty*, we have advised that a business has “business contacts” in an official’s jurisdiction if the business regularly sells or purchases products in the jurisdiction. (*Baty*, 5 FPPC Ops. at 12; *Vinson Advice Letter*, No. A-91-041.)

If Kern County purchases goods or services on the web site, the e-company itself will not be selling the goods or services. But the e-company stands to gain financially from these web site transactions. If no purchases are made by anyone, the e-company will go out of business. Consequently, although the e-company will not be selling a product in Kern County, it will still have “business contacts” in the jurisdiction. That is because it plans to directly solicit county representatives to use the web site, and coordinate sales transactions between the county and the vendors on the web site. The e-company plans to engage in these activities solely to make a profit. As such, these activities constitute “doing business in the jurisdiction.” Thus, your investment interest in the e-company is an economic interest for purposes of the Act.

³ You have not provided any facts indicating whether or not a parent, subsidiary or otherwise related business entity of the e-company does business in Kern County. (Section 82034.) A business entity is “otherwise related” to another business entity if it has a controlling ownership interest in the other business entity. (Regulation 18703.1.) It is unclear under your facts whether the venture capital firms providing funding to the e-company are otherwise related to the e-company. If they are, and they do business in Kern County, then your investment interest will be considered an economic interest for purposes of the Act.

⁴ The Commission may consider a regulation later this year that would define “doing business in the jurisdiction” for purposes of the conflict of interest rules. Thus, this issue may be revisited at a later date.

Once a public official identifies his or her economic interests, the official must evaluate whether it is reasonably foreseeable that a decision will have a material financial effect on one or more of those economic interests. This determination takes three steps, which this letter discusses in detail below as Steps 4, 5 and 6. First, the official must determine whether the economic interest will be directly or indirectly involved in the decision. (Regulation 18700(b)(4).) Based upon the type of involvement, the official must then find the applicable materiality standard set forth in Commission regulations. (Regulation 18700(b)(5).) After finding the applicable materiality standard, the official must then decide whether it is reasonably foreseeable that the standard will be met. (Regulation 18700(b)(6).)

4. Direct Versus Indirect Involvement

Regulation 18704.1 describes whether a business entity, in which a public official has an economic interest, is directly involved in a decision before an official's agency:

“(a) A person, including business entities, sources of income, and sources of gifts, is directly involved in a decision before an official's agency when that person, either directly or by an agent:

(1) Initiates the proceeding in which the decision will be made by filing an application, claim, appeal, or similar request or;

(2) Is a named party in, or is the subject of, the proceeding concerning the decision before the official or the official's agency.

A person is the subject of the proceeding if a decision involves the issuance, renewal, approval, denial or revocation of any license, permit, or other entitlement to, or contract with, the subject person.”

When the e-company offers its web service to the county, it will be directly involved in the county's decision to subscribe to the web service. However, the issue we must address is whether the company is directly involved in subsequent decisions to approve the purchase of items on the web site after the county has already decided to subscribe to the web service. First, it does not appear that the company will be “initiating” those purchases. (Regulation 18704.1(a)(1).) Instead, the county will be initiating the purchases by issuing RFPs. In addition, it does not appear that the company will be a named party or the subject of the purchases. (Regulation 18704.1(a)(2).) The purchases will involve a contract between a vendor and the county. Although the company will benefit indirectly, it will not be a party to these contracts. Therefore, we conclude that the e-company will not be directly involved in a decision to approve an online purchase. Since the e-company is not directly involved in the decision, we consider the company to be indirectly involved for purposes of finding the relevant materiality standard.

5. Applicable Materiality Standard

Regulation 18705.1(b) (copy enclosed) sets forth the materiality standards for business entities that are indirectly involved in a decision, including business entities that are sources of income to a public official. (Regulation 18705.3(b)(1).) The standards in the regulation vary depending upon the size of the business entity. The bigger the business entity, the greater the monetary impact a decision must have in order for the effect to be material.

The e-company is a close corporation that probably qualifies to be listed on NASDAQ, and might even qualify to be listed on the New York Stock Exchange. If the e-company meets the financial standards for listing on NASDAQ, but not the New York Stock Exchange, the effect of a given decision is material if the decision will result in an increase or decrease of the company's: (1) gross revenues by \$30,000 or more in a fiscal year; (2) incurred or avoided expenses by \$7,500 or more in a fiscal year; or (3) value of assets or liabilities by \$30,000 or more. (Regulation 18705.1(b)(6).) If, however, the e-company meets the financial standards for listing on the New York Stock Exchange, the effect of the decision is material if it will result in an increase or decrease in the company's: (1) gross revenues by \$150,000 or more in a fiscal year; (2) incurred or avoided expenses by \$50,000 or more in a fiscal year; or (3) value of assets or liabilities by \$150,000 or more. (Regulation 18705.1(b)(5).)

Once a public official finds the relevant materiality standard, the official must determine whether it is reasonably foreseeable that the materiality standard will be met as a result of the decision.

6. Foreseeability

A financial effect is considered reasonably foreseeable at the time a governmental decision is made if there is a substantial likelihood that it will occur. (Regulation 18706.) A material financial effect need not be a certainty as a result of the decision, but it must be more than a mere possibility. (*In re Thorner* (1975) 1 FPPC Ops. 198.)

Consequently, the question becomes whether or not it is substantially likely that a decision to approve a given online purchase will have a material financial effect on the e-company. If the e-company qualifies for listing on NASDAQ, but does not qualify for listing on the New York Stock Exchange, the specific question you must answer is whether it is substantially likely that the decision will increase or decrease the e-company's: (1) gross revenues by \$30,000 or more in a fiscal year; (2) incurred or avoided expenses by \$7,500 or more in a fiscal year; or (3) value of assets or liabilities by \$30,000 or more. (Regulation 18705.1(b)(6).)

Each purchase the county makes on the e-company's web site will benefit the business to some degree. Therefore, you must decide whether that benefit will be material under the

standards described above. When making that determination, you may consider each legitimately distinct purchase to be a separate governmental decision. (A purchase is legitimately distinct from another purchase, for example, if each purchase originated from two different RFPs.) If you find that a particular purchase will increase the e-company's gross revenues by the specified amount, or have some other material financial effect on the company, you will be disqualified from approving that purchase.

7. Public Generally Exception

An official who otherwise has a conflict of interest in a decision may still participate in the decision if the "public generally" exception applies. (Section 87103.) For this exception to apply, the decision must affect the official's economic interests in substantially the same manner as it would affect a significant segment of the public. (Regulation 18707.) For decisions that affect a business entity, a "significant segment" is 50 percent of all businesses in the jurisdiction or the district the official represents. (Regulation 18707(b)(1)(B).) Since the e-company will be providing a unique service, it does not appear that the public generally exception will apply.

8. Legally Required Participation

The eighth step pertains to the "legally required participation" rule. (See Regulation 18708.) This rule applies only in rare cases where several public officials in the same agency are simultaneously disqualified. It does not appear that legally required participation rule is relevant to your request.

If you have other questions regarding this matter, please contact me at (916) 322-5660.

Sincerely,

Luisa Menchaca
Assistant General Counsel



By: Julia Bilaver
Staff Counsel, Legal Division

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Enclosure