



FAIR POLITICAL PRACTICES COMMISSION

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December 7, 2009

Rebecca Jones
Councilmember
City of San Marcos
770 Calle De Soto
San Marcos, CA 92078

Re: Your Request for Advice
Our file No. A-09-244

Dear Ms. Jones:

This letter responds to your request for advice regarding the conflict-of-interest provisions of the Political Reform Act (the "Act").¹ This letter is based on the facts presented; the Fair Political Practices Commission (the "Commission") does not act as a finder of fact when it renders assistance. (*In re Oglesby* (1975) 1 FPPC Ops. 71.) Please note that our advice is based solely on the provisions of the Act. We therefore offer no opinion on the application, if any, of other conflict-of-interest laws such as common law conflict of interest, or Government Code Section 1090.

QUESTION

Do you, as a city councilmember, have a conflict of interest in upcoming city council decisions affecting Costco because of your husband's furniture-building contracts with a furniture company that sells to Costco?

CONCLUSION

Costco is not a source of income to you for purposes of the Act, so you will have no conflict of interest regarding Costco if you participate in upcoming city decisions affecting Costco. As for your other economic interests, it is unlikely the city council's upcoming decisions regarding Costco will have a reasonably foreseeable material financial effect on those interests. As stated below, however, you must make the ultimate determination of foreseeability based on the impact of each decision.

¹ The Political Reform Act is contained in Government Code Sections 81000 through 91014. All statutory references are to the Government Code, unless otherwise indicated. The regulations of the Fair Political Practices Commission are contained in Sections 18110 through 18997 of Title 2 of the California Code of Regulations. All regulatory references are to Title 2, Division 6 of the California Code of Regulations, unless otherwise indicated.

FACTS

You are a member of the City of San Marcos City Council (the "City Council"). The City Council will soon be making decisions regarding Costco, which currently operates a retail facility in San Marcos, and is purchasing a piece of property from San Marcos and intends to rebuild and expand its current store.

Your husband, Paul Jones, designs furniture for Whalen Furniture ("Whalen"). He is an independent contractor and is paid only by Whalen. Whalen in turn sells the furniture to Costco through its corporate office. As part of his contract with Whalen, whenever Whalen sells your husband's designs to Costco, or any other retailer, your husband gets an "override" on the sale. He received more than \$1,000 from Whalen in the past 12 months. He also anticipates a "test" to be completed in April of 2010. For the "test," Whalen will sell a certain amount of a product to Costco. If that product sells well enough, Costco will pick it up on a larger scale.

Whalen is not a publicly traded company, and you confirmed that Whalen's net income is not less than \$750,000.

Your husband does not have a contract with Costco, nor is he named in the contract between Costco and Whalen. Rather, Costco contracts to buy Whalen furniture and does business directly with Whalen. Your husband contracts with Whalen directly and does not have any direct business with Costco.

ANALYSIS

Section 87100 prohibits any public official from making, participating in making, or otherwise using his or her official position to influence a governmental decision in which the official has a financial interest. A public official has a "financial interest" in a governmental decision, within the meaning of the Act, if it is reasonably foreseeable that the governmental decision will have a material financial effect on one or more of the public official's economic interests. (Section 87103; Regulation 18700(a).) The Commission has adopted an eight-step standard analysis for deciding whether an individual has a disqualifying conflict of interest in a given governmental decision, which we apply to your question. (Regulation 18700(b)(1)-(8).)

Step One: Are you a public official for purposes of the Act?

As a member of the San Marcos City Council, you are a public official under the Act. (Section 82048.) Consequently, you may not make, participate in making, or otherwise use your official position to influence any decisions that will have a reasonably foreseeable material financial effect on any of your economic interests. (Regulations 18702.1-18702.4.)

Step Two: Will you be making, participating in making, or using or attempting to use your official position to influence a governmental decision?

The City Council will be reviewing and making decisions about a property sale and a building project in San Marcos. Consequently, you will be called upon to make, participate in making, or otherwise use your official position to influence these decisions. (Regulations 18702.1-18702.4.)

Step Three: What are your economic interests?

A public official has a financial interest within the meaning of Section 87103 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 one of five enumerated economic interests, including:

1. An economic interest in any business entity in which the public official has a direct or indirect investment worth \$2,000 or more. (Section 87103(a); Regulation 18703.1(a)); or in any business entity in which the public official is a director, officer, partner, trustee, employee, or holds any position of management. (Section 87103(d); Regulation 18703.1(b).)
2. An economic interest in real property in which he or she has a direct or indirect interest of \$2,000 or more. (Section 87103(b); Regulation 18703.2.)
3. An economic interest in any source of income, including promised income, aggregating \$500 or more within 12 months prior to the decision. (Section 18703(c); Regulation 18703.3.) "Income" includes a pro rata share of any income of any business entity or trust in which the individual or spouse owns, directly, indirectly or beneficially, a 10-percent interest or greater. (Section 82030(a).)
4. An economic interest in any source of gifts to him or her if the gifts aggregate to \$420 or more within 12 months prior to the decision. (Section 87103(e); Regulation 18703.4.)
5. An economic interest in his or her personal finances, including those of his or her immediate family. (Section 87103; Regulation 18703.5.)

Business entity: We have previously considered independent contractors such as your husband, as owning a "business entity" under the Act. He is the sole owner and operator of this business. You have an economic interest in your husband's business as a furniture designer due to your community property interest in the business as a spouse. (See Section 82034.)

Source of income: You have a source of income economic interest in your own income as well as your community property share of your husband's income. (Section 82030(a).) For any person from whom your husband receives \$1,000 in the previous 12 months, or is promised income over \$1,000, you have an economic interest in that source of income (your community property share being at least \$500). Your husband's source of income is Whalen Furniture. Thus, you have an economic interest in Whalen as a source of income to you.

A question also arises as to whether Costco, or any other person to whom Whalen Furniture sells your husband's designs, is a source of income to you by virtue of the "override" provision in your husband's contract with Whalen. Under that provision, your husband (and thus you, under community property law) receives extra income, presumably a percentage, from Whalen on each sale of your husband's design. While Costco or other purchasers of the design are an indirect source of income, we do not think the Act intended to reach this far in funding as a source of income for purposes of its conflict-of-interest provisions.

We arrive at this conclusion for several reasons. First, your husband's sole contractual obligation is with Whalen Furniture and not the persons to whom Whalen sells his designs. Consequently, he has no control over who these purchasers are or how much they pay. Second, Commission regulations defining source of income in somewhat similar situations are more limited in their scope. Regulation 18703.3(c)(2)(C) defines the sources of income to a real estate agent as the brokerage for whom the agent works, the client represented by the agent and any person who receives a finder's or referral fee for referring the sale to the agent. Significantly, a person who purchases or sells the real property from which the agent receives his or her fee is not a source of income to the agent unless it is the agent's client. Likewise, Regulation 18703.3(c)(2)(E) provides that the sources of income to a stockbroker are the brokerage business for whom the broker works and the client whose stock is being traded, but not the seller or purchaser of the stock to or from the client.

Furthermore, Regulation 18703.3(d) provides that a source of "incentive compensation" to an official is a source of income to the official. Under this provision, incentive compensation is essentially income based on a predetermined formula an employee earns over and above salary sales or purchases of goods or services. The accumulated sales or purchases, however, must be "in direct response to the effort of the official" and incentive compensation does not include, among other things, "payments for personal services which are not marketing or sales." The Commission adopted this provision in response to its formal opinion in *In re Hanko*, 16 FPPC Ops. 1 (2002), where an official made educational presentation to health care providers on products, but did not take orders or conduct actual sales or transactions, and beyond a base salary, was paid a percentage of the cost of products sold in her territory to the providers through intermediary wholesalers. As codified in the regulation, there was direct contact and sales activity between the official and the purchasers of the products.

All of these regulations indicate that the Commission has been reluctant to extend the reach of the Act's conflict-of-interest provisions to indirect sources of income with which the official has no indirect sales-oriented connection. We thus think that Costco and similarly situated purchasers of your husband's designs fall outside the definition of source of income to you in this situation, and therefore are not your economic interests for purposes of the Act's conflict-of-interest provisions.

Personal Financial Effects: You also have an economic interest in your personal finances and those of your immediate family. As stated in Regulation 18703.5, a governmental decision will have a personal financial effect "if the decision will result in the personal expenses, income, assets, or liabilities of the official or his or her immediate family increasing or decreasing."

You have not advised us of any other economic interests. Our analysis is therefore limited to those listed.

Step Four: Will your economic interests be directly or indirect involved in the city council's decisions?

Once an official identifies an economic interest, he or she must determine whether the economic interest is directly or indirectly involved in the specific decision in question. (Regulations 18700(b)(4), 18704(a).) Having established the degree of involvement, the official can then identify the materiality standard appropriate to the circumstances. (Regulation 18700(b)(5).) In analyzing whether a source of income is directly or indirectly involved² in a decision before an official's agency, we look to Regulation 18704.1(a), which states in pertinent part:

"(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 a 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."

Stated more specifically, a source of income is directly involved in a decision before an official's agency when that source of income, directly or by an agent, is a named party in, or is the subject of, a proceeding if the decision involves the issuance,

² An economic interest that is not directly involved is considered to be indirectly involved. (Regulation 18704.)

renewal, approval, denial or revocation of any license, permit, or other entitlement to, or contract with, the source of income. (Regulation 18704.1(a).)

Business Entity: Your husband's business is not a named party in, or the subject of the decisions before the council, nor does the decision involve the issuance, renewal, approval, denial or revocation of any license, permit, or other entitlement to, or contract with his business. It is, therefore, indirectly involved.

Source of income: Your source of income economic interest in this instance is Whalen Furniture. As Whalen only contracts with the subject of the proceeding, it is not directly involved in the proceeding.

Personal financial effects: A public official always has an economic interest in his or her personal finances. A governmental decision will have an effect on this economic interest if the decision will result in the personal expenses, income, assets, or liabilities of the official or his or her immediate family increasing or decreasing. (Section 87103; Regulation 18703.5.)³

Steps Five and Six: Will there be a reasonably foreseeable material financial effect on your economic interests?

Materiality

A conflict of interest may arise only when the reasonably foreseeable impact of a governmental decision on a public official's economic interests is material. (Regulation 18700(a).) Different standards apply to determine whether a reasonably foreseeable financial effect on an economic interest will be material, depending on the nature of the economic interest and whether that interest is directly or indirectly involved in the agency's decision. You have economic interests in your husband's business, both as a business entity and a source of income. You further have an economic interest in Whalen as a source of income.

Your husband's business:

For economic interests in business entities *indirectly* involved in a decision, including business entities that are a source of income to an official, the materiality standard is given at Regulation 18705.1(c).

The thresholds for materiality under this regulation vary with the size of the business. Based upon the facts you have provided, Regulation 18705.1(c)(4) provides the applicable materiality threshold for a relatively small business such as your husband's

³ A financial effect on the gross revenues, expenses, or value of assets and liabilities of a business entity in which a public official has a direct or indirect investment interest, are not considered separate financial effects on the official's personal finances and would not be analyzed separately under the "personal financial effects" rule. (Regulation 18705.5(a).) Accordingly, the personal financial effects rule does not appear to apply to your circumstances and we will not discuss it further.

furniture design. Under this regulation, the financial effect of a governmental decision on a business is material if it is reasonably foreseeable that:

“(A) The governmental decision will result in an increase or decrease in the business entity’s gross revenues for a fiscal year in the amount of \$20,000 or more; or,

“(B) The governmental decision will result in the business entity incurring or avoiding additional expenses or reducing or eliminating existing expenses for a fiscal year in the amount of \$5,000 or more; or,

“(C) The governmental decision will result in an increase or decrease in the value of the business entity’s assets or liabilities of \$20,000 or more.”

Based on the information you provided and the standards above, it is unlikely that the effect of the governmental decision will be material. There is no information to connect the potential expansion of the Costco to increased sales of the furniture your husband designs in such a capacity as to provide your husband’s business with a sales increase of \$20,000 or more. Each public official must determine, however, based on the facts presented, whether the standards above apply.

Whalen as a Source of income:

As stated above, the materiality thresholds for indirectly involved sources of income that are business entities are found in Regulation 18705.1(c) (enclosed). In this case, Whalen Furniture, which is not publicly traded, but has an annual income of at least \$750,000, would fall under Regulation 18705.1(c)(3).

Regulation 18705.1(c)(3) states that the financial effect of the governmental decision on such a company is material if it is reasonably foreseeable that:

- (A) The governmental decision will result in an increase or decrease to the business entity's gross revenues for a fiscal year in the amount of \$500,000 or more; or,
- (B) The governmental decision will result in the business entity incurring or avoiding [*11] additional expenses or reducing or eliminating existing expenses for a fiscal year in the amount of \$ 100,000 or more; or,
- (C) The governmental decision will result in an increase or decrease in the value of assets or liabilities of \$ 300,000 or more.

There are no facts to suggest that the governmental decision regarding the potential expansion of Costco’s San Marco store will affect Whalen to the degree listed in the regulation above (i.e. increasing its sales by \$500,000 or more in a fiscal year). The

City Council will be making decisions regarding Costco rebuilding its current store, adding a gas station, and increasing the size of their parking lot. You have not suggested that the store rebuilding will affect the amount of furniture that Costco buys from Whalen. If that is the case, the decisions' effect on Whalen will not be material.

Foreseeability

Once a public official has determined the materiality standard applicable to each of his or her economic interests, the next step is determining whether it is "reasonably foreseeable" that the standard will be met. A material financial effect on an economic interest is "reasonably foreseeable" if it is substantially likely that one or more of the materiality standards will be met as a result of the governmental decision. (Regulation 18706(a).) An effect need not be certain to be considered "reasonably foreseeable," but it must be more than a mere possibility. (*In re Thorner* (1975) 1 FPPC Ops. 198.)

Ultimately, whether a material financial effect is foreseeable at the time a decision is made depends on facts and circumstances peculiar to each case. (*In re Thorner, supra*, at 198.) Because the Commission does not act as a finder of fact in providing advice (*In re Oglesby* (1975) 1 FPPC Ops. 71), the foreseeability of a particular financial effect is a determination that must be left, in most instances, to the informed judgment of the public official.

As you have stated the facts, your husband has a contract with Whalen and Whalen contracts with the national office for Costco. A decision that would affect an individual Costco retail outlet is unlikely to have an impact on national level sales that would make it reasonably foreseeable that the materiality thresholds enumerated herein would be met. As stated above, however, the decision regarding foreseeability must be made by the public official.

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

Sincerely,

Scott Hallabrin
General Counsel



By: Heather M. Rowan
Counsel, Legal Division

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