



FAIR POLITICAL PRACTICES COMMISSION

428 J Street • Suite 620 • Sacramento, CA 95814-2329
(916) 322-5660 • Fax (916) 322-0886

Supersedes the *Goldstein* Advice Letter, No. A-12-035.

The *Houston* Advice Letter, No. I-13-031 supersedes the *Goldstein* Advice Letter, No. A-12-035 to the extent that *Goldstein* finds a subcontractor indirectly involved in a governmental decision, so long as the subcontractor does not initiate the proceeding and is not named in the bidding process, even when the official with an economic interest in the subcontractor knew that the subcontractor would ultimately be hired.

April 30, 2013

Michael R.W. Houston
Cummins & White, LLP
2424 S.E. Bristol, Suite 300
Newport Beach, CA 92660

Re: Your Request for Informal Assistance
Our File No. I-13-031

Dear Mr. Houston:

This letter responds to your request for advice, on behalf of Newport Beach City Council Member Tony Petros, 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 does not act as a finder of fact when it renders advice. (*In re Oglesby* (1975) 1 FPPC Ops. 71.) Because your question is general in nature and not limited to a specific governmental decision, we are treating your request as one for informal assistance.²

Please note that the Commission does not provide advice on bodies of law outside the confines of the Act. Thus, we offer no opinion on the application of other incompatible activities and conflict-of-interest laws that may apply including, but not limited to, common law conflict of interest and Government Code Section 1090.

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.

² Informal assistance does not provide the requestor with the immunity provided by an opinion or formal written advice. (Section 83114; Regulation 18329(c)(3).)



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Dear Mr. Houston:

This letter responds to your request for advice, on behalf of Newport Beach City Council Member Tony Petros, 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 does not act as a finder of fact when it renders advice. (*In re Oglesby* (1975) 1 FPPC Ops. 71.) Because your question is general in nature and not limited to a specific governmental decision, we are treating your request as one for informal assistance.²

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QUESTION

In light of his position with and investment in LSA Associates, Inc. ("LSA"), may Councilmember Petros take part in governmental decisions involving clients of LSA under each of the following conditions: (1) work performed by LSA is in another jurisdiction and Councilmember Petros personally performs work for the client; (2) work performed by LSA is in another jurisdiction and Councilmember Petros does not personally perform work for the client;

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(3) the governmental decision involves a project of a LSA client, and LSA is a consultant or sub-consultant for the project; and (4) the governmental decision involves a project of a LSA client, and LSA provides services to the client for a different project within the City but not for the project involved in the decision?

CONCLUSION

Where the governmental decision involves a project of a LSA client and LSA has been or will be hired as a consultant or sub-consultant for the project, including scenario (3), LSA is directly involved in the decision. In these circumstances, the reasonably foreseeable financial effect on Councilmember Petros' economic interests in LSA is presumed to be material, and Councilmember Petros is prohibited from making, participating in making, or using his official position to influence the decision.

For a decision involving a client of LSA that LSA is indirectly involved in, such as a project that LSA has not and will not be hired to assist with, including scenarios (1), (2), and (4), Councilmember Petros may take part in the decision, barring any other potentially disqualifying economic interest he may have, so long as the reasonably foreseeable financial effect on LSA is less than the applicable materiality threshold under Regulation 18705.3(c).

FACTS

Cummins & White, LLP, serves as outside counsel for the City of Newport Beach and requests assistance on behalf Newport Beach City Council Member Tony Petros. Councilmember Petros was elected to the Newport Beach City Council on November 6, 2012, and was sworn into office on or about December 11, 2012. Additionally, Councilmember Petros has been employed at LSA Associates, Inc. ("LSA") for the past 28 years. He currently serves as a Principal of the LSA Transportation Group in LSA's Irvine office.

The LSA is a consulting firm specializing in environmental, planning, and transportation services. Councilmember Petros' job duties can be described generally as (1) assisting LSA develop business for the transportation segment of LSA's consultancy; (2) managing preparation of technical studies for project proposals relating to land development, capital projects, and policy documents for clients of the Irvine office; and (3) providing quality control and overall project and business management for LSA's transportation group at the Irvine office. Councilmember Petros also has the ability to control and manage decisions relating to clients of LSA's Irvine office or other clients of LSA that he actively works for on projects.

LSA's annual revenue on a firm-wide basis ranges between \$30 to 35 million. As a principal, Councilmember Petros owns approximately 3.46% of LSA's privately-held shares. These shares exceed \$2,000 in value. Councilmember Petros also receives compensation from LSA in the form of income/salary and benefits. While bonuses for the overall performance of LSA are available, bonuses have not been made in the past several years. You state that

Councilmember Petros does not receive “incentive compensation” from LSA based on the success of a client’s projects or on the basis of the success of the work performed by LSA.

ANALYSIS

Section 87100 prohibits any public official from making, participating in making, or 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 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 any given governmental decision.

Step One: Is the person a “public official?”

The Act’s conflict-of-interest provisions apply only to “public officials.” (Sections 87100, 87103; Regulation 18700(b)(1).) A “public official” is “every member, officer, employee or consultant of a state or local government agency . . .” (Section 82048.) As a member of the Newport Beach City Council, Councilmember Petros is a public official.³

Step Two: Is the official making, participating in making, or influencing a governmental decision?

A public official “makes a governmental decision” when the official, acting within the authority of his or her office or position, votes on a matter, obligates or commits his or her agency to any course of action, or enters into any contractual agreement on behalf of his or her agency. (Regulation 18702.1.) A public official “participates in a governmental decision” when, acting within the authority of his or her position and without significant intervening substantive review, the official negotiates, advises, or makes recommendations to the decisionmaker regarding the governmental decision. (Regulation 18702.2.) For a decision before the official’s own agency, a public official is attempting to use his or her official position to influence a decision if, for the purpose of influencing, the official contacts or appears before any member, officer, employee, or consultant of the agency. (Regulation 18702.3.) Councilmember Petros is making, participating in making, or influencing a governmental decision any time he takes part in decisions by the Newport Beach City Council.

³ If a public official’s office is listed in Section 87200, which specifically includes city council members, and the official has a conflict of interest in a decision noticed at a public meeting, the official must: (1) verbally identify each type of economic interest involved in the decision as well as details of the economic interest, as discussed in Regulation 18702.5(b)(1)(B), on the record of the meeting and immediately prior to the discussion of the item; (2) recuse himself or herself; and (3) leave the room for the duration of the discussion and/or vote on the item. For closed sessions, consent calendars, absences, and speaking as a member of the public regarding personal interests, special rules found in Regulation 18702.5 subdivisions (c) and (d) apply. (Section 87105.)

Step Three: What are the official's economic interests?

Of the economic interests recognized under the Act⁴, those potential interests implicated by your account of the facts are the following:

Business Entity – A public official has an economic interest in a business entity in which he or she has a direct or indirect investment of \$2,000 or more, or in which he or she is a director, officer, partner, trustee, employee, or holds any position of management. (Section 87103(a) and (d); Regulation 18703.1(a) and (b).)

Source of Income – A public official has an economic interest in any source of income, including promised income, which aggregates to \$500 or more within 12 months prior to the decision. (Section 87103(c); Regulation 18703.3.)

Personal Finances – A public official has an economic interest in his or her personal finances, including those of his or her immediate family. This is known as the “personal financial effects” rule. (Section 87103; Regulation 18703.5.)

LSA: From the facts you have provided, Councilmember Petros is a principal at LSA and has an investment of \$2,000 or more in the business. Thus, Councilmember Petros has an economic interest in LSA as a business entity. (Section 87103 (a) and (d).) In addition to his economic interest in LSA as a business entity, Councilmember Petros also has an economic interest in LSA as a source of income assuming his income from LSA, in the 12 months prior to the decision, is \$500 or more. (Section 87103(c).)

LSA Clients: Under Section 82030(a), if a public official owns a 10-percent or greater interest in a business, customers who are sources of income to that business are also sources of income to the public official. However, based upon the facts provided, Councilmember Petros owns less than a 10-percent interest in LSA and, therefore, does not have an economic interest in LSA Clients.

We also note potential economic interests in clients of LSA as sources of “incentive compensation.” Pursuant to Regulation 18703.3(d):

“Incentive compensation does not include: salary; commission income; bonuses for activity not related to sales or marketing, the amount of which is based solely on merit or hours worked over and above a predetermined minimum; and such executive incentive plans as may be based on company performance, provided that the formula for determining the amount of the executive's incentive income does not include a correlation between that amount and increased profits derived from increased business with specific and identifiable clients or customers

⁴ Our analysis is limited to the potential economic interests you have identified.

of the company. Incentive compensation also does not include payments for personal services which are not marketing or sales.”

However, you stated that Councilmember Petros does not receive “incentive compensation” based on the success of a client’s projects or on the basis of the success of the work performed by LSA, and that any potential bonus is based upon the overall performance of LSA. Accordingly, it does not appear that Councilmember Petros has an economic interest in any client of LSA as a source of incentive compensation.

Personal Finances: 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.) However, 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 is not considered a separate financial effect on an official’s personal finances and would not be analyzed separately under the “personal financial effects” rule. Accordingly, the personal financial effect rule does not appear to apply to the facts you have presented.

Step Four: Are the official’s economic interests directly or indirectly involved in the decision?

Regulation 18704.1(a) states that a business entity or source of income is directly involved in a decision before the official’s agency when that business entity or source of income, 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.”

Business entities and sources of income that are not directly involved in governmental decisions are regarded as indirectly involved. (Regulations 18704.1(b), 18705.1(a)(2), and Regulation 18705.3(b).)

You have sought assistance regarding governmental decisions involving a client of LSA. To the extent that the decision involves a project of a client of LSA and LSA will not be hired to provide services, LSA is indirectly involved in the governmental decision. A more difficult determination is whether LSA is directly or indirectly involved in a decision regarding a project

for which LSA has been, or knows it will be, hired by the applicant as a consultant or sub-consultant on the project.

In this regard, previous Commission advice letters have examined whether or not a subcontractor has been named in the bid or otherwise identified in determining whether the subcontractor is directly involved, but these letters have not been consistent in their conclusions. In the *White* Advice Letter, No. I-11-128, we determined that a company is directly involved in a decision involving a project if the company has been identified as either the primary contractor or a subcontractor. Nonetheless, in the *Goldstein* Advice Letter, No. A-12-035, we found that a subcontractor will not be directly involved in the decision, so long as the subcontractor does not initiate the decision and is not named in the bidding process of the master contract, despite the fact that the official with an economic interest in the subcontractor knew that the subcontractor would be hired after the contract was executed.

Pursuant to Commission regulations, the broadest standard to determine whether a subcontractor is directly or indirectly involved is whether the subcontractor is a “subject of the decision,” further defined as a decision involving any “entitlement” to the subcontractor. Whether or not the subcontractor has been specifically identified in the bidding process for a project is immaterial to this determination when it is known to the public agency, including the official with an economic interest in the subcontractor, that the subcontractor has or will be hired for the project. Accordingly, LSA is directly involved in any decision involving a project of a client of LSA if Councilmember Petros knows that LSA has been hired or will be hired by the client for the project.⁵

Further supporting this analysis, the plain language of Section 87100 forbids a public official from making, participating in making, or in any way attempting to use his or her official position to influence a governmental decision in which the official *knows or has reason to know he has a financial interest*. (Emphasis added.) In light of this statutory mandate, Regulation 18704.1(a) cannot be read to permit an official to take part in a decision under the more lenient indirectly involved standard, when the official knows that a business in which the official has an economic interest has been or will be hired by the project’s applicant to perform work on the project.

Steps Five and Six: Will there be a reasonably foreseeable material financial effect on the official’s economic interests?

Materiality

A conflict of interest may arise only when the reasonably foreseeable effect of a governmental decision on a public official’s economic interests is material. (Regulation

⁵ We therefore supersede the *Goldstein* Advice Letter, *supra*, to the extent that it finds a subcontractor indirectly involved in a governmental decision, so long as the subcontractor does not initiate the proceeding and is not named in the bidding process, even when the official with an economic interest in the subcontractor knew that the subcontractor would ultimately be hired.

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.

For economic interests in business entities *directly* 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(b), which states, "the financial effects of a government decision on a business entity which is directly involved in the government decision is presumed to be material." This presumption of materiality may be rebutted only by proof that it is not reasonably foreseeable that the governmental decision will have *any* financial effect on the business entity. However, the size of the financial effect does not matter. If there is *any* financial effect at all, even "one-penny," that effect is presumed to be "material."

Alternatively, 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. Councilmember Petros should consult Regulation 18705.1(c) to ensure that he identifies the threshold actually appropriate to LSA. For instance, Regulation 18705.1(c)(2) provides that the financial effect of a governmental decision on a indirectly involved business, not publically traded, with a net income of no less than \$2.5 million for its most recent fiscal year, 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 additional expenses or reducing or eliminating existing expenses for a fiscal year in the amount of \$200,000 or more; or,

"(C) The governmental decision will result in an increase or decrease in the value of assets or liabilities of \$500,000 or more."⁶

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

⁶ Additionally, under the "nexus" rule, any reasonably foreseeable financial effect on a source of income to a public official is deemed material if the official receives or is promised income to achieve a goal or purpose, which would be achieved, defeated, aided, or hindered by the decision. (Regulation 18705.3(c).) While Councilmember Petros is presumptively disqualified from taking part in a decision involving a project of a client of LSA if LSA is, has been, or will be hired by the client for that specific project, he may also be disqualified from a decision under the "nexus" rule if the decision involves a client that has hired LSA for general purposes such as promoting the client's interest within the city. However, because you have limited your questions to decisions involving clients that have hired LSA for specific projects, the "nexus" rule is not applicable to the scenarios presented.

the standard will be met. A material financial effect on an economic interest need not be certain or even substantially likely to be “reasonably foreseeable,” but it must be more than a mere possibility. (Regulation 18706(a); *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.*) Because the Commission does not act as a finder of fact in providing advice (*In re Oglesby, supra*), 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.

Based upon the facts you have provided, it will be essential to determine whether LSA is directly involved in any particular decision before the city council. To the extent that LSA is directly involved in the decision, such as a decision involving a project of a client of LSA that has or will hire LSA for the project, the reasonably foreseeable financial effect on Councilmember Petros’ economic interests in LSA is presumed to be material and Councilmember Petros is prohibited from making, participating in making, or using his official position to influence the decision.

For a decision that LSA is indirectly involved in, such as a project of a client that LSA has not and will not be hired to assist with, Councilmember Petros may take part in the decision, barring any other potentially disqualifying economic interest he may have, so long as the reasonable foreseeable financial effect on LSA is less than the applicable materiality threshold under Regulation 18705.3(c).

Steps Seven and Eight: Does the governmental decision come within any exception to the conflict-of-interest rules?

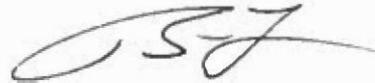
Even if an official has a conflict of interest, disqualification is not required if the governmental decision affects the official’s economic interests in a manner that is indistinguishable from the manner in which the decision will affect the public generally. (Section 87103; Regulation 18707(a).) Additionally, in certain rare circumstances, an official may be called upon to take part in a decision despite the fact that the official may have a disqualifying conflict of interest under the “legally required participation” exception. This exception applies only in certain very specific circumstances where the government agency would be paralyzed from acting. (Section 87101; Regulation 18708.)

However, you have not presented any facts indicating that the “public generally” or the “legally required participation” exceptions are applicable to Councilmember Petros’ circumstances, so we do not address them further.

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

Sincerely,

Zackery P. Morazzini
General Counsel

A handwritten signature in black ink, appearing to read 'BGL', written over a horizontal line.

By: Brian G. Lau
Counsel, Legal Division

BGL:jgl