

Fair Political Practices Commission

Memorandum

To: Chair Ravel, Commissioners Eskovitz, Garrett, Montgomery, and Rotunda

From: Zackery P. Morazzini, General Counsel
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Subject: Conflict of Interest Codes

Date: May 7, 2012

The purpose of this memorandum is to provide the Commission with a background on pertinent issues staff has been dealing with regarding conflict of interest codes, and to seek direction with regard to those issues.

Specifically, staff seeks to inform the Commission and asks the Commission to approve the following:

(1) Staff's legal interpretation (as set forth in this memorandum) that conflict of interest code disclosure categories must be narrowly tailored to the type of economic interests that will foreseeably be affected by a designated employee's decisionmaking;

(2) Staff's modification of the prior practice regarding conflict of interest codes staff reviews in that staff will apply the requirement to tailor disclosure to all economic interests, including gifts.

(3) Staff's plan to begin developing procedures to better ensure that proper codes are adopted on a timely basis, and developing regulations to require all code reviewing bodies to post copies of the conflict of interest codes on-line for all agencies they oversee. The initial stages of this process will be holding interested persons meetings and other modes of outreach to stakeholders, including other code reviewing bodies (most commonly city councils and county boards of supervisors), bodies that must have a code, and persons that must comply with a code. Staff intends to begin holding public meetings with other interested parties and other code reviewing bodies to discuss how to bring consistency to the process.

(4) Finally, staff would like to work to simplify and clarify the regulations that govern newly created positions.

Staff has already begun to address some of the issues raised in this memorandum in its capacity as code reviewing body for most state agencies. Regulatory changes would be developed in the normal process but would not be presented to the Commission until late this year or early next year.

Background/Legal Requirements

An express purpose of the Political Reform Act (the “Act”),¹ as set forth in Section 81002, subdivision (c), is to ensure that the assets and income of public officials that may be materially affected by their official actions be disclosed, so that conflicts of interest may be avoided. The Act’s conflict of interest provisions are set forth in Chapter 7 commencing with Section 87100.

Article 1 provides the general prohibitions. Section 87100 states that “ 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 [or she] knows or has reason to know he [or she] has a financial interest.” Section 87103 enumerates what “financial interests” are covered by the Act. A public official has a “financial interest” in a governmental 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, a member of his or her immediate family, or on any of the following:

“(a) Any business entity in which the public official has a direct or indirect investment worth two thousand dollars (\$2,000) or more.

“(b) Any real property in which the public official has a direct or indirect interest worth two thousand dollars (\$2,000) or more.

“(c) Any source of income, except gifts or loans by a commercial lending institution made in the regular course of business on terms available to the public without regard to official status, aggregating five hundred dollars (\$500) or more in value provided or promised to, received by, the public official within 12 months prior to the time when the decision is made.

“(d) Any business entity in which the public official is a director, officer, partner, trustee, employee, or holds any position of management.

“(e) Any donor of, or any intermediary or agent for a donor of, a gift or gifts aggregating two hundred fifty dollars (\$250) or more in value provided to, received by, or promised to the public official within 12 months prior to the time when the decision is made. The amount of the value of gifts specified by this subdivision shall be adjusted biennially by

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.

the Commission to equal the same amount determined by the Commission pursuant to subdivision (f) of Section 89503.²

“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, or by a business entity or trust in which the official, the official’s agents, spouse, and dependent children own directly, indirectly, or beneficially a 10-percent interest or greater.” (Section 87103.)

Article 2 of Chapter 7 commencing with Section 87200 provides disclosure requirements for certain high level officials, who are identified in Section 87200. Generally, these officials include all elected state officials, judges, members of any board of supervisors, city council, planning commission, mayors, city managers, city attorneys and county counsel, city and county treasurers and chief administrative officers , members of the Public Utilities Commission, State Energy Resources Conservation and Development Commission, the Coastal Commission, the FPPC, as well as any public official who manages public investments. These individuals are commonly referred to as statutory filers or 87200 filers and are required to file a “statement disclosing his [or her], investments, ...interest in real property, ... income” each year on a financial disclosure statement referred to as a Statement of Economic Interest, (“SEI”) also known as a Form 700. (Section 87203.)³

In order to effectuate the Act’s disclosure requirements and to ensure that the public is made aware of potential conflicts of interest, Section 87300 requires every agency to adopt and promulgate a conflict of interest code covering all agency officials (other than statutory filers) who engage in governmental decisionmaking (see below). These officials are referred to as “code filers.” The agency’s conflict of interest code must specifically designate the employees of the agency who are required to file SEIs disclosing their reportable investments, business positions, interests in real property, and sources of income.⁴ An agency’s conflict of interest code is a fundamental tool for carrying out the Act’s conflict of interest prohibition. Under Section 87300, the requirements of an agency’s conflict of interest code have the force of law, and any violation of those requirements is deemed a violation of the Act.

The Act requires each agency conflict of interest code to be formulated at the most decentralized level possible (Section 87301) and approved by the agency’s code reviewing body. The Commission is the code reviewing body for state agencies and multicounty agencies; the county board of supervisors for local county agencies; and the

² The current gift limit amount is \$420.

³ These officials are required to disclose *all* economic interests. All other officials who are required to file SEIs do so under agency conflict of interest codes (“code filers”).

⁴ These codes are supposed to be tailored so that only those economic interests that may reasonably foreseeably be materially affected by any governmental decision the official may make are required to be disclosed.

city council for city agencies. The Attorney General is the code reviewing body for the Commission's conflict of interest code.

Under Section 87302(a), the persons who are to be designated in an agency's conflict of interest code are the officers, employees, members, and consultants of the agency, whose position *involves the making or participating in the making of governmental decisions that may foreseeably have a material effect on an official's financial interests* and the types of financial interests that may foreseeably be affected by these decisions.

This is different than the application of 87100, which requires an official to evaluate foreseeability *at the time the decision is made*. With respect to code disclosure, this has to be set well in advance of any specific decision being made. In other words, disclosure is intended to reveal foreseeable sources of conflict of interest in the abstract, not every remotely possible conflict of interest. And as a safety valve, the Act would require disqualification under 87100 if the conflict is foreseeable *at the time of the decision*, even if it was not foreseeable when the code was drafted or when the employee filed their last Form 700.

Section 87302(b) states an agency's conflict of interest code must require every designated employee of the agency to file an annual statement of economic interests for the previous year, at a time specified in the agency's conflict of interest code. On the annual statement of economic interests, a designated employee must disclose his or her reportable economic interests held during the preceding calendar year.

Finally, Section 87309 provides that: “[n]o Conflict of Interest Code or amendment shall be approved by the code reviewing body or upheld by a court if it:

“(a) Fails to provide reasonable assurance that all foreseeable potential conflict of interest situations will be disclosed or prevented;

(b) Fails to provide to each affected person a clear and specific statement of his [or her] duties under the Code; or

(c) Fails to adequately differentiate between designated employees with different powers and responsibilities.”

Once an agency has adopted a conflict of interest code, Section 87306(a) requires the agency to amend its code “when change is necessitated by changed circumstances, including the creation of new positions [that] must be designated . . . , and relevant changes in the duties assigned to each position.” Subdivision (b) further requires every state agency to file a biennial report identifying changes in its code no later than March 1 of each odd-numbered year.⁵ Regulation 18736 states that the biennial report shall contain a statement either:

⁵ Local agencies are required under Section 87306.5 to review their conflict of interest codes and, “if a change in its code is necessitated by changed circumstances,” submit an amended code.

“(1) That the agency has reviewed its conflict of interest code; that the code accurately designates all positions which make or participate in the making of governmental decisions; that the disclosure categories assigned those positions accurately require the disclosure of all investments, business positions, interests in real property, and sources of income which may foreseeably be affected materially by the decisions made by those designated positions; and that the code includes the provisions required by Government Code Sections 87302, 89502, and 89503; or

(2) That the agency has reviewed its conflict of interest code, and has determined that amendment is necessary to include new positions which must be designated; to make changes to the reportable sources of income, investments, business positions, or real property; to make changes to the positions assigned; or to change or add the provisions required by Government Code Sections 87302, 89502, and 89503.”

Examples of changed circumstances that would require an amendment to the code are provided under subdivision (b) and include:

“(1) The creation of positions which involve the making, or participation in the making, of decisions which may foreseeably have a material effect on any financial interest;

(2) The reclassification, renaming, or deletion of previously designated positions;

(3) The addition, deletion, or modification of statutorily required provisions of a code;

(4) The addition, deletion, or modification of the specific types of investments, business positions, interests in real property, and sources of income which are reportable.”

When an agency submits a report that an amendment to its code is necessary, “the agency shall submit the amendment to the Commission within 90 days of the date of the report.” (Regulation 18736(d).)

Section 87303 provides that “[n]o conflict of interest code shall be effective until it has been approved by the code reviewing body.” Once the code reviewing body has received a proposed conflict of interest code, Section 87303 directs that it shall do one of the following:

“(a) Approve the proposed code as submitted.

(b) Revise the proposed code and approve it as revised.

(c) Return the proposed code to the agency for revision and resubmission within 60 days. The code reviewing body shall either approve the revised code or revise it and approve it. When a proposed conflict of interest code or amendment is approved by the code reviewing body, it shall be deemed adopted and shall be promulgated by the agency.”

Sections 87304 and 87305 address what actions may be taken if an agency fails to submit, adopt, or amend a proposed code. Section 87304 states:

“If any agency fails to submit a proposed conflict of interest code or amendments, or if any state agency fails to report amendments pursuant to subdivision (b) of Section 87306 within the time limits prescribed pursuant to Section 87303 or 87306, the code reviewing body may issue any appropriate order directed to the agency or *take any other appropriate action*, including the adoption of a conflict of interest code for the agency. If the code reviewing body does not issue an appropriate order or take other action within 90 days of the deadline imposed on the agency as prescribed in Section 87303 or 87306, *the Commission may issue any appropriate order directed to the agency or take any other appropriate action, including the adoption of a conflict of interest code for the agency.* The Commission shall consult with the agency before ordering the adoption of a conflict of interest code for the agency.” (Emphasis added.)

There are no Commission regulations addressing what may constitute an “appropriate order directed to the agency” or “take any other appropriate action.”

Section 87305 further provides:

“If after six months following the deadline for submission of the proposed Conflict of Interest Code to the code reviewing body no Conflict of Interest Code has been adopted and promulgated, the superior court may, in an action filed by the Commission, the agency, the code reviewing body, any officer, employee, member or consultant of the agency, or any resident of the jurisdiction, prepare a Conflict of Interest Code and order its adoption by the agency or grant any other appropriate relief. The agency and the code reviewing body shall be parties to any action filed pursuant to this section.”

The remainder of this memorandum addresses problem areas that staff has identified as needing revision – ultimately by adoption of or amendment to Commission regulations to be presented at a later date.

Issue No. 1: Proper Disclosure Categories

As was discussed briefly in last year’s staff memorandum relating to the amendments to the gift regulations, requiring over-disclosure is a frequent problem in

agency conflict of interest codes. Case law going back to before the Act was adopted makes it clear that financial disclosure laws must meet certain constitutional standards, and overbreadth must be avoided. (See *City of Carmel-by-the Sea v. Young* (1970), 2 Cal.3d 259; *County of Nevada v. MacMillen* (1974), 11 Cal. 3d 662.)

In the *Carmel* case, the California Supreme Court considered a financial disclosure law that generally required every public official and candidate for state or local office to file a statement disclosing the nature and extent of his or her investments in excess of \$10,000 (excluding homes used for personal or recreational purposes) as well as those of his or her spouse and minor children. The court held that the attempted regulation undertook an overbroad intrusion into the right of privacy and thereby impermissibly restricted the right to seek or hold public office or employment.

Four years later, in *County of Nevada* (*supra*) the same court addressed a new financial disclosure law and found that it had been “specially tailored to meet and satisfy the primary concerns of our *Carmel* ruling.” The court explained that its “major objection” to the provisions considered in the *Carmel* case was that “No effort is made to relate the disclosure to financial dealings or assets which might be *expected* to give rise to a conflict of interest; that is, to those having some rational connection with or bearing upon, or which might be affected by, the functions or jurisdiction of any particular agency, whether statewide or local, or on the functions or jurisdiction of any particular public officer or employee.” (*County of Nevada, supra*, p. 671 [emphasis added].)

In 1976, the Commission was asked to consider two questions with respect to the Act’s conflict of interest disclosure provisions: (1) does the Act permit the designation of positions that do not entail the making or participation in the making of governmental decisions; and (2) does the Act permit a code reviewing body to approve a conflict of interest code that contains provisions requiring disclosure of financial interests that may not foreseeably be affected materially by decisions made or participated in by designated employees? (*Alperin* Opinion, 3 FPPC Ops. 77.)

The Commission concluded that not only does the Act prohibit such activities, but Section 87309(c) specifically prohibits a code reviewing body from approving a conflict of interest code that designates positions that do not entail the making or participation in the making of governmental decisions or that requires disclosure of financial interests that may not foreseeably be affected materially by the decisions made or participated in by employees holding any designated position.

The Commission also confirmed that “[t]he responsibility for determining if a code meets these specifications rests with the ‘code reviewing body.’” (*Alperin, supra*, p.2.) The Commission went on to consider what this obligation entails, and, under Section 87309(c), what a conflict of interest code must contain before it may be approved by a code reviewing body, concluding:

“This provision is intended to ensure, first, that a conflict of interest code requires financial disclosure only from employees required to be designated by Section 87302(a) [the position engages in governmental decisionmaking] and,

second, *that a code relate disclosure to the specific duties of such designated employees.* Thus, a code reviewing body would fail to fulfill its obligation under Section 87309(c) if it allowed designation of positions in a code which, to quote the language of Section 87309(c) do not entail the ‘making or participation in the making’ of governmental decisions. *It would be equally improper for a code reviewing body to require disclosure of interests which may not foreseeably be affected materially by decisions made or participated in by designated employees.”* (Alperin, *supra*, pp. 3-4 [emphasis added].)

However, the Act also recognizes that there may be instances where the duties of a designated employee can be so broad that narrow tailoring is simply not possible. Thus, Section 87310 provides:

“If the duties of a designated employee are so broad or indefinable that the requirements of Section 87309 [requiring narrow tailoring for disclosure by position] cannot be complied with, the Conflict of Interest Code shall require the designated employee to comply with the requirements of Article 2 of this chapter [full disclosure under Section 87200].”

Ensuring the proper level of disclosure for designated employees is critical to striking a proper balance between heading-off potential conflicts of interest and individuals’ right to privacy. This can only be done if code reviewing bodies take a careful look at the specific duties of those positions being designated in their codes.

However, with respect to one economic interest, Staff has failed to apply a tailoring approach. The Act’s definition of income includes gifts. (Section 82030.) The definition provides:

“‘Income,’ other than a gift, does not include income received from any source outside the jurisdiction and not doing business within the jurisdiction, not planning to do business within the jurisdiction, or not having done business within the jurisdiction during the two years prior to the time any statement or other action is required under this title.”

In 1979, the California Supreme Court considered the definition of income in the Act in light of its previous decisions in *Carmel* and *County of Nevada*. (See *Hays v. Wood*, (1979) 25 Cal. 3d 772.) The case dealt primarily with issues concerning source of income and the disclosure of the names of clients paying attorneys and brokers who were also public officials required to file Statements of Economic Interest. The court found that “the provisions of the Act were within the guidelines established by *City of Carmel* and *Nevada*,” stating as one of the reasons for its finding:

“As originally enacted, the current Act’s definition of reportable ‘income’ encompassed, with specified exceptions, ‘income of any nature from any source.’ (Citations omitted.) *Thus, it failed to include a provision crucial to our validation of the 1973 statute – a limitation to*

income with substantial potential for influence on public duties. Effective January 1, 1977, however, the section was amended to exclude ‘income received from any source outside the [officials] jurisdiction’ if the entity constituting the income’s source neither plans to do business nor has done business within the jurisdiction in the two years preceding the report. By so confining reportable ‘income,’ the amended Act adopts an objective standard of material relevance to actual conflict of interest similar to that which we approved in Nevada. (11 Cal. 3d at pp. 669-670.)” (*Hays*, supra, p. 782, emphasis added.)

However, because of the statutory definition of income which excludes “gifts” from this jurisdictional limit, statutory filers are required to report gifts from any source, anywhere in the world.

In contrast, the reporting obligations of those who are required to file under an agency conflict of interest code are required to be tailored to “relate the disclosure to financial dealing or assets which might be expected to give rise to a conflict of interest; that is to those having some rational connection with or bearing upon, or which might be affected by, the functions or jurisdiction of any particular agency, whether statewide or local, or on the functions or jurisdiction of any particular public office or employee.” (*Carmel*, supra.) Or as the Commission stated in its *Alperin* Opinion, “that a code relate disclosure to the specific duties of such designated employees.”

Thus, while the statutory language of Section 82030 places no jurisdictional limitation on the reporting of gifts, the case law and statutes regarding the drafting of a proper conflict of interest code prohibit the required reporting of sources of gifts if there is no nexus between the gift and any possible impact of an official’s functions, jurisdiction, or decision.

However, the practice of some code-reviewing bodies has been to ignore the specific statutes dealing with proper conflict of interest codes in favor of a literal interpretation of the general definition of income. This has led to the misconception, even on the part of the Commission at times⁶, that gifts cannot be limited by jurisdiction in a conflict of interest code.

As noted above, this position conflicts with the Act, case law, and Commission opinions require that the reporting of gifts, like all other reportable economic interests, be tailored to the duties of the position.⁷ If an employee’s duties do not relate to the

⁶ Admittedly, staff has not always given consistent advice on the jurisdictional issue regarding gifts over the years, and some older advice letters may have to be rescinded in part.

⁷ Both reporting of real property and source of income economic interests are commonly limited in codes to apply only to those interests that are affected by the duties of the position. For example, we recently approved a code where inspectors’ reporting of real property interests was limited to two miles of their inspection sites and not to all real property in the jurisdiction. Sources of income are almost always limited to sources of the type that do business with the agency and not any business whatsoever. Reporting of gifts should be equally tailored.

activities of someone who lives in China, there is no reason for the employee to have to report a gift from that person.

Additionally, many of the payments currently being required to be reported under broadly worded codes are not considered gifts under the recent amendments to the gift regulations. Implementing a narrowing construction of the gift reporting requirements will also bring codes into conformity with the gift regulations themselves.

Staff requests that the Commission authorize staff to begin training other code-reviewing bodies to follow the requirements that reporting of gifts be tailored to the duties and responsibilities of the position designated in the conflict of interest code.

Issue No.2: Required Updating of Agency Conflict of Interest Codes

As stated above, Section 87306 requires every agency to amend its conflict of interest code when change is necessitated by the creation of new positions or relevant changes in the duties of existing positions and for state agencies to file a biennial report to the code reviewing body indicating changes to its existing code, or indicate that no change is necessary. Local code reviewing bodies are required, under Section 87306.5, to direct every agency under its jurisdiction to review, and change if necessary, the provisions of their codes every two years.

Despite this provision, there are currently some 25 state agency conflict of interest codes in the review process that have not been amended since the last century, and many more that are in need of review. Although conflict of interest codes form the basis for SEI filing, which in turn provide the basis for public review of potential conflicts of interest of public officials, review of these codes have not been getting the attention from many code reviewing bodies they deserve. Conflict of interest codes are simply too important to allow them to go so long without being updated.

For example, the Commission was recently faced with a problem where a small local agency refused to adopt any code at all and the local code reviewing body was ineffective at gaining compliance. After several contacts in which the agency was not cooperative, the Commission took the step of adopting a code for them without any input. After the code was adopted, one boardmember filed, and then immediately resigned. The rest refused to file. The matter has now been referred to the Enforcement Division.

Staff believes the Commission should take a more active approach and direct staff to develop procedures to ensure that proper codes are adopted on a timely basis. These procedures should include outreach programs, training and development, and perhaps developing regulations defining what role the Commission, or any other code reviewing body, may take under its authority to “take any appropriate action” under Section 87304.

Issue No. 3: Online Posting of All Agency Codes

In this age of the Internet there is no reason why agency conflict of interest codes should not be posted on-line. Currently, codes must be obtained by requesting them from the agency or the code reviewing body. This is not always convenient, and despite the provisions of Section 81008, these codes are not always easily obtainable.

Section 81008 provides:

(a) Every report and statement filed pursuant to this title is a public record open for public inspection and reproduction during regular business hours, *commencing as soon as practicable*, but in any event not later than the second business day following the day on which it was received. No conditions *whatsoever* shall be imposed upon persons desiring to inspect or reproduce reports and statements filed under this title, nor shall any information or identification be required from these persons. ...

It is difficult to justify how “commencing as soon as practicable” would mean anything other than immediately with respect to producing an agency’s conflict of interest code. This document should be readily available without any need to conduct a search of the agency’s record. It should not take two days. Yet many agencies treat such requests as a normal public records request and inform the requestor that the agency has up to 10 days to respond to the request. Some require the requestor to provide identification, despite the fact that this is prohibited by law. Many, if not most, are unaware of the provisions of Section 81008.

Regulation 18750, which sets forth the procedures for the promulgation and adoption of conflict of interest codes for state agencies, supports this interpretation. Subdivision (m) thereof contains a provision similar to that contained in Section 81008, except that it leaves out the “commencing as soon as practicable” and “no later than two days from the request” language.

“(m) Each agency’s code shall be maintained in the office of the chief executive officer of the agency, who shall make the code available for public inspection and reproduction during regular business hours commencing the effective date of the code. No conditions whatsoever shall be imposed upon persons desiring to inspect the conflict of interest code of the agency, nor shall any information or identification be required from such person. ...”

Even if an agency attempts to be helpful in immediately responding to the request, they do not always produce the right document. For example, staff is aware that one state agency that was requiring its employees to file under a rejected code, produced this same rejected code when requested to provide a copy of its current conflict of interest code. At least it was being consistent.

In recent months the Commission has moved toward on-line posting for other documents, including SEIs for elected officials and Form 802 reporting for agency tickets

and tickets provided for ceremonial roles. On-line posting of state agency conflict of interest codes by the Commission would solve all of the problems discussed above. Additionally, staff believes the Commission should direct staff to develop regulations to require all code reviewing bodies to post on-line copies of the conflict of interest codes for all agencies they oversee.

Issue No. 4: Future Simplification of Commission Regulations

Numerous regulations related to conflict of interest code development have not been recently reviewed or amended and are overcomplicated.

- Regulation 18730 establishes the required provisions for a conflict of interest code. This section, referred to as the model code, was developed as the Commission's code, and can be used by other agencies by incorporating its provisions by reference in their own code. In almost all cases, that is what is done. The regulation contains 4,080 words covering 14 pages in double-spaced type. This regulation needs to be reviewed with a goal toward simplification.
- Regulation 18734 addresses interim disclosure for newly created positions that are not yet included in the code. This regulation needs to be further modified to deal with staff hired in new agencies before a code is adopted.
- Regulation 18736, stating what a state agency must do in complying with its biennial code update responsibilities, needs to be clarified to ensure that positions that are eliminated be removed from the conflict of interest code and that the level of reporting for each designated position corresponds with the duties of the position.
- Article 3, including Sections 18750 through 18754 concern the procedures for the promulgation and adoption of agency conflict of interest codes, including procedures for obtaining exemption from the requirements. Staff proposes that these sections be reviewed and updated where appropriate to clarify and simplify the provisions contained therein.

Staff would like to examine the entire conflict of interest code promulgation process with an eye to updating and refining it. The process as currently implemented can be improved to better provide relevant information to the public.