Fair Political Practices Commission

Memorandum

To: Vice Chair Eskovitz, Commissioners Casher, Wasserman, and Wynne

From: Zackery P. Morazzini, General Counsel
William J. Lenkeit, Senior Commission Counsel

Subject: Determining the Material Financial Effect of a Decision on a Real Property Interest

Date: April 7, 2014

Introduction:

This project continues with staff's ongoing examination of the Political Reform Act's (the "Act") conflict of interest regulations. At the June 2013 Commission meeting, staff presented a detailed memorandum and discussion regarding our first step towards revising the standards for determining what is a "material financial effect" on a financial interest, by discussing the need for a new standard applicable to real property financial interests. Our discussion specifically addressed the need to abandon the current 500 foot/one penny rule as overly simplistic and move toward developing a standard that more rationally takes into account factors that may reasonably give rise to concerns that a public official may have a conflict of interest. In other words, we should have a procedure for analyzing conflicts of interest involving real property that actually analyzes the potential for a conflict of interest, rather than just drawing a circle to determine the answer. (See Staff memorandum, dated June 20, 2013.)

Review - Conflict of Interest Project:

Last year, staff began the process of completely revising the regulations implementing the Act's conflict of interest provisions, which are primarily provided in Section 87100 and 87103.[1] Following the language of these two statutes, the current regulations were crafted to direct the official through an eight-step process to analyze any potential conflict of interest question. (See Staff Memorandum dated April 15, 2013.) While this process was perhaps a useful tool at the time of its development, and was a step forward from what had existed before, it grew to become a cumbersome mechanism

[1] The basic rule is provided in Section 87100: "No public official at any level of state or local government shall, make, participate in making or in any way attempt to use his official position to influence a governmental decision in which he knows or has reason to know he has a financial interest." Section 87103 provides that an official "has a financial interest in a decision … if it is reasonably foreseeable that the decision will have a material financial effect, distinguishable from the public generally, on the official" or one of his/her financial interest as enumerated.

that relied more on mechanical formulas than thoughtful consideration and common sense approaches. It also led to protracted staff advice letters that in many cases provided an accurate analysis, but no useful conclusions.

The current project was conceived in an attempt to develop a more concise and useful method to better guide and assist public officials subject to the Act's conflict of interest provisions. In addressing this need, part of what we envisioned was developing a method that would allow staff to provide a better tuned and more reasoned analysis that would lead to more helpful advice upon which officials could rely.

The first clarification occurred at the August 16, 2012 Commission meeting where new language was adopted to analyze the meaning of what is considered "reasonably foreseeable."[2] The term reasonably foreseeable had been misdefined over the years in staff advice letters, requiring that a financial effect be "substantially likely," thereby making it unlikely that a conflict of interest would be present under the Act in even some of the most obvious situations. (See Staff memorandum dated August 6, 2012.)[3] Additionally, because little guidance was provided in applying either of these terms, with a typical advice letter stating that chance of the financial effect occurring had to be somewhere between a "mere possibility" and an "absolute certainty," this "step" was generally the source of our inability to give definitive advice.

Once we had addressed the biggest problem in our analysis, at the April 25, 2013 meeting, staff presented a new organizational structure for the revised conflict of interest regulations package under new Regulation 18700. This structure consolidated the conflict of interest analysis from an 8-Step process into a 4-Step process. The meaning of "reasonably foreseeable" under current Regulation 18706 will be moved from the end to the beginning, as Step 1 (addressed under Regulation 18701). The materiality standards currently set forth in Regulations 18704 et seq. and 18705 et seq., will be placed in Step 2 under new Regulations 18702 et seq. The "public generally" language, currently set forth under Regulation 18707 et seq., will be moved under new Regulations 18703 et seq. Finally, the language currently existing under Regulation 18702 regarding making and participating in a governmental decision will be moved to the final step of the analysis, Step-4, and placed in new Regulation 18704 et seq. [4]

The current project takes the first step towards revising the materiality standards, and the first financial interest standard examined is the real property standards. As stated

---

[2] Although new regulatory language has been presented and approved by the Commission for the work on this project so far, because these changes will all need to be synched with changes yet to come, official implementation of the new regulatory language will be postponed until we get to the point that the overall package will mesh.

[3] This is currently contained in Step 6 of the 8-step process under Regulation 18706.

[4] It is staff's goal to have these regulations reorganized and presented the next time the Commission considers amendments to the conflict of interest regulations. At that point, the project should be at about its half-way stage, and the new structure will be workable. Accordingly, the amendments already approved may be implemented then and the remaining amendments can be added to that foundation.

above, analysis of the problems of the current rule was presented at the June 2013 Commission meeting and, as promised at that meeting, staff now returns with proposed language concerning materiality standards for real property decisions. Unlike the problems addressed regarding the "reasonably foreseeably" determination, where an ambiguous standard led to multiple meanings, the real property materiality standard is too rigid and arbitrary and creates an unreasonable approach to determining potential conflicts.

Proposed Regulation 18702

As established by newly proposed Regulation 18700, which was presented at the April 25, 2013 Commission meeting, determining whether a financial effect is material will be moved to Step 2 of the conflict of interest analysis and addressed under Regulation 18702 et seq. This Regulation 18700 simply serves as the introductory regulation for the Step 2 materiality standards, laying out the index for the specific standards applied. It does nothing more than to indicate where to look for the appropriate materiality standards for each of the statutorily established financial interests under the Act. The only materiality standard implicated under the current project is contained under proposed Regulation 18702.2.

Proposed Regulation 18702.2

Organization: The existing provisions addressing real property materiality are contained in Regulations 18704.2 and 18705.2. Because our reorganization under this project has eliminated the "directly involved/indirectly involved" approach contained in the current analysis under Step 4 and Step 5 (Regulations 18704.2 and 18705.2 for real property interests), the surviving elements of these two regulations are now being combined into one real property materiality regulation. To make it easier to follow what is being changed, staff has attached copies of current Regulations 18704.2 and 18705.2 to clearly show what moved and where, and what has been removed. Additionally, the attached copy of the proposed new version of Regulation 18702.2 indentifies new language as well as what is either existing language or a slight modification (for clarity) of the existing language in the current regulations.

The following discussion will address the substantive changes being recommended to establish the test to determine a *material* financial effect on a real property interest.

Discussion: The first substantive change, as mentioned above, results from the elimination of the directly/indirectly involved step. Other than the 500 foot rule, this reorganization does not remove any of the factual criterion that currently subjects an official to a conflict of interest. However, the proposed regulation will now incorporate all of these factors as part of one substantive analysis, rather than using them to set up two different materiality presumptions. Under the newly proposed language, the separate presumptions will cease to exist.

As pointed out at the June Commission meeting, there are essentially two problems with the 500 foot rule. First, it potentially makes participating in every decision, no matter how trivial or insignificant, a conflict of interest for any official who has a real property interest located within 500 feet of the property at issue in the decision. Secondly, while not explicit in the current language, because of the organization of the regulations, potential conflict issues beyond 500 feet are not fully analyzed for a true conflict of interest. The analysis simply stops at that point.

Accordingly, proposed subdivision (a) will now list all of the factors to be considered for making a materiality determination for a real property interest, other than a leasehold interest (which is discussed separately below).

Paragraphs (a)(1) through (a)(6) contain standards that are currently contained within Regulation 18704.2(a)(2-6) (the "directly involved/one penny rule" factors under the existing test).

Paragraphs (a)(7) through (a)(10) take the factors from current Regulation 18705.2(b)(1)(A-C) that are currently considered in order to rebut the presumption of "no materiality" and retasks them to be definitions of materiality. As stated above, through this process, all factors are now provided in one place.

New language proposed in paragraphs (a)(5) and (a)(8) provides one substantive change in the conflicts analysis that is intended to remove the separate analysis of a material financial effect on real property value when the impact of the decision is to affect the income producing ability of the real property. In that case, once a determination has been made as to whether there will or will not be a reasonably foreseeable financial effect on any income producing potential, a separate determination will not need to be conducted to determine the reasonably foreseeable financial effect on the real property itself.

Additionally, the proposed language contained in paragraph (a)(6) modifies the existing language applicable to decisions relating to construction of, or improvements to streets, water, sewer, storm drainage or similar facilities, other than repairs (repairs are treated separately). Under the existing regulation, an official will always have a conflict of interest in these situations if he or she "will receive new or improved services" as a result of the decision.

In its present form, the language is quite broad, having almost limitless applications. For example, decisions to make improvements to a levy to prevent flooding or to widen a street to improve traffic flow can provide "new and improved services" to a substantial portion of a community. The question here is whether prohibiting participation in these types of public projects that benefit a great number of people and are part of normal, regular, and ordinary government business furthers the purposes of the Act. Staff believes it does not.

Instead, staff believes that what we really should be looking at are situations where the official will receive a unique benefit from the construction or improvement beyond what is provided to a larger segment of the public. In this regard, the language addressing real property decisions involving construction of, or improvements to, streets, water, sewers, storm drainage or similar facilities will no longer establish a conflict of interest unless the services can be distinguished from services typically provided to similarly situated properties in the official's jurisdiction, or that the official will receive a unique benefit or detriment by the decision.

Paragraphs (a)(11) through (a)(14) offer the Commission an option to replace the existing one-size-fits-all 500 foot rule with a less arbitrary rule that takes into account the magnitude of the decision. Having discussed the shortcomings of an arbitrary measurement standard above, we note that the measuring stick approach is not without some usefulness in providing guidance if the measurements are used as guidelines rather than absolute boundaries. The options presented are intended to offer an alternative that would ease the transition from the bright-line 500 foot rule. In addition, the 500 foot rule has not been completely eliminated, but instead modified. It will now provide Commission staff with a viable option through the advice letter process in those situations where absurdities are otherwise created, and allow staff to make a determination as to whether there is a conflict of interest.

Finally, proposed subdivision (a)(15) would apply a general, overall rule that essentially follows the same common principle that courts have followed for hundreds of years in conflict of interest cases, recognizing that an official must act in the interest of the public, unburdened by his or her own personal concerns. In this regard, the language would provide that a general conflict of interest exists in any decision that would raise reasonable concerns of a foreseeable financial effect on the official's property by a reasonably prudent person exercising due care under the circumstances – a common standard applied in many legal proceedings.

Subdivision (b) addresses real property leasehold interests, and subdivisions (c) and (d) provide exceptions and definitions, respectively. Once again, the language in each of these subdivisions is taken from existing regulations, only now entirely contained in one regulation. Most of the language is taken word-for-word from the existing regulations, with some slight modifications for clarification.

The only substantive change is in the addition of paragraph (d)(4). Under the proposed language, an official's financial interest in real property will no longer include his or her common ownership interest held by a homeowners association, which is included as part of the official's ownership interest in any property in which he or she has an undivided interest. The current rule, established through advice letters, is that the 500 foot distance runs not just from the official's property, but from the boundaries of any common property included in the ownership interest of his or her real property. This rule has lead to some absurd results. For example, consider two housing developments of

equal size on each side of a parcel of property affected by a governmental decision. One development is surrounded by a greenbelt, maintained by the homeowners association made up of all the homeowners in that development. The other has no greenbelt and the homeowners own no land in common. Under current law, all of the homeowners in the first development would have a conflict of interest while only those in the second developments living within the first 500 feet of the property would be presumed to have a conflict. While this change is less important with the modification of the 500 foot rule, the current rule serves no useful purpose. This language makes it clear where the boundaries of an official's ownership in real property ends.

Attachment 1: Proposed Repeal of Regulation 18704.2 Determining Whether Directly or Indirectly Involved in a Governmental Decision: Interest in Real Property

Attachment 2: Proposed Amendment of Regulation 18705.2 Material Financial Effect on a Real Property – Standard