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Why Take 8 Steps When You Can Get There In 4? The FPPC's New Conflict of Interest Regulations for Public Officials in California

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I. INTRODUCTION

In the spring of 2015, application of a key law intended to rout out actual and apparent impropriety in State and local government decision-making in California fundamentally changed when the Fair Political Practices Commission (FPPC) completed its two-plus-year initiative to revamp the regulations that implement the conflict of interest provisions of the Political Reform Act (PRA).[1]

In sum, the PRA's conflict of interest provisions prohibit public officials from using their governmental positions to financially benefit themselves, their investments, their affiliated organizations, their employers or other sources of income.[2] Government Code Section 1090 *et seq.* (Section 1090) also prohibits public officials from being financially interested in any contract made by them in their official capacity, or by any body or board of which they are members.[3] The FPPC's revised regulations, which are the focus of this article, only concern the PRA and not Section 1090.

The FPPC's revised regulations change how one analyzes and guards against potential conflicts and even the appearance of divided loyalties. These changes are important to public officials, employees, and agencies, as well as the private and non-profit entities that may have matters pending before local or state governments. The changes simplify the analysis of what is – and what is not – a disqualifying financial interest, replacing a complicated 8-step analysis that required us to flip from regulation to regulation, check stock listings, perform calculations, and more. We now apply a streamlined 4-step analysis that focuses less on numerical calculations and picayune factual details and more on discouraging major violations.

Now, once we determine if a local government official, employee or consultant is a "public official" under the regulations, and whether the individual has a "financial interest" under the law – which could be a source of income to the official or his or her spouse, real property, or more – we walk through a simplified 4-step analysis with re-ordered, revised regulations.

For a specific application of the new 4-step test to real estate professionals, please see page 10 of this edition.

II. NEW 4-STEP ANALYSIS: IS THERE A DISQUALIFYING CONFLICT OF INTEREST?

Under the PRA, a public official at any level of state or local government may not make, participate in making, or in any way use or attempt to use his or her official position to influence a governmental decision when the official knows or has reason to know he or she has a disqualifying financial interest. An individual has a prohibited conflict of interest with regard to a particular government decision if the decision will have a reasonably foreseeable material financial effect, distinguishable from the effect on the public generally, on the official, on his or her immediate family, or on any of their financial interests detailed in the PRA.[4] Financial interests include: (1) business investments ($2,000 or more)[5] and positions;[6] (2) real estate ($2,000 value or more);[7] (3) sources of income of $500 in past 12 months;[8] (4) sources of gifts of $460 in past 12 months (up from $440 as of 1/1/2015);[9] and (5) measurable financial benefit or loss on the official or official's immediate family member.[10]

A. Step 1: Is it <u>reasonably foreseeable</u> that the governmental decision will have a <u>financial effect</u> on any of the public official's financial interests?

If a financial interest is a named party of, or the subject of, a governmental decision, the answer is yes, it is clearly reasonably foreseeable that the decision may have a financial effect on the financial interest.[11] The analysis gets more complicated, and is about probabilities, when a financial interest is not explicitly involved in a decision.

A financial effect does not need to be likely to be considered reasonably foreseeable, it simply needs to be a realistic possibility and more than hypothetical or theoretical.[12] If a financial effect is not expected absent extraordinary circumstances outside of the public official's control, then it is not reasonably foreseeable.[13] FPPC Regulation 18701 provides a non-exhaustive list of six factors to consider when determining if a financial effect is a realistic possibility:

1. The extent to which the occurrence of the financial effect is contingent upon intervening events.[14]
2. Whether the public official should anticipate a financial effect on his or her financial interest as a potential outcome under normal circumstances when using appropriate due diligence and care.[15]
3. Whether the public official has a financial interest that is of the type that would typically be affected by the terms of the governmental decision or whether the governmental

decision is of the type that would be expected to have a financial effect on businesses and individuals similarly situated to those businesses and individuals in which the public official has a financial interest.[16]

4. Whether the financial effect of the governmental decision on the public official's financial interest might compromise an official's ability to act in the best interests of the public.[17]

5. Whether the governmental decision will provide or deny an opportunity, or create an advantage or disadvantage for one of the official's financial interests.[18]

6. Whether the public official has the type of financial interest that would cause a similarly-situated person to weigh the advantages and disadvantages of the governmental decision on their financial interest in formulating a position.[19]

If, after considering these factors, it is not a realistic possibility that the decision will have a financial effect on the public official's financial interest, there is no conflict of interest under the PRA. If a financial effect is reasonably foreseeable or a realistic possibility, proceed to Step 2.

B. Step 2: Will the reasonably foreseeable financial effect be material?

The second step is the core of the analysis, and to answer it, we apply FPPC Regulation 18702. Materiality is about importance: is the anticipated effect a big deal? For example, is a company going to get a new permit, pay penalties or gain or lose a contract? Is the value or use of property going to change? Is a stock price or company's value going to go up or down? A financial effect is not material if it is nominal, inconsequential, or insignificant.[20]

There are different materiality standards for each of the five financial interests defined in the regulations.[21] Some of the materiality standards, such as the standard for sources of income, refer to other materiality standards. Once you become familiar with the materiality standards for business entities and real property, the materiality regulations for sources of income and gifts become less convoluted.

1. *Business Entities*

A financial effect on a business entity is material when a business is an initiating party, an applicant, the subject of inspection/action/proceeding, or the contracting party, or a government agency's action is directed solely at the business entity.[22] A financial effect is also material if the decision's financial effect would contribute to a change in the stock price of a publicly-traded company or the value of a privately-held company.[23] Examples include improvements to surrounding streets; changes in the amount of competition, supply, demand, or regulations governing products or services; increases or decreases to the business' tax burden, debt, or financial or legal liabilities.[24]

2. *Real Property*

FPPC Regulation 18702.2 outlines the instances when an interest in real property is materially affected. These instances include when a decision involves: a general or specific plan;[25] zoning or rezoning; de-/annexation, in-/exclusion in/from a jurisdictional boundary;[26] taxes, fees or assessments;[27] sale, purchase, or lease;[28] license, permit or land use entitlement;[29] street, water, sewer or similar improvements;[30] changes to development potential, income-producing potential or "highest and best use";[31] or changes to the character of the parcel by substantial alterations to traffic levels or intensity of use, including parking, views, privacy, noise levels, or air quality.[32] If the decision affects real property within 500 feet of the property line of the official's real property it is material except if the FPPC determines otherwise in writing.[33] FPPC Regulation 18802.2 also contains a catch-all provision: real property is materially affected if the decision would influence the market value of the official's property.[34] Finally, FPPC Regulation 18702.2 describes instances when a decision has a material effect on leasehold interests such as a change to the termination date of a lease, or the actual or legally allowable uses of a property.[35] FPPC Regulation 18702.2(c) contains exceptions to the materiality regulations including decisions solely concerning repairs, replacement or maintenance of existing streets water, sewer, storm drainage, or similar facilities.

3. *Source of Income – sale of goods and services, sale of personal or real property, and individuals*

A financial effect on a source of income is material if the source is explicitly involved in a decision or if the source meets the materiality standards for business entities or real property.[36]

The reasonably foreseeable financial effect of a governmental decision on an official's source of income from the sale of goods and services is material when the source is: (1) a claimant, applicant, respondent, contracting party, or is otherwise named or identified as the subject of the proceeding; (2) an individual (including their immediate family) who will receive a measurable financial benefit or loss from a decision;[37] (3) an individual who has an interest in a business entity or real property that will be financially affected under the materiality standards outlined above; (4) a nonprofit that will receive a measurable financial benefit or loss;[38] (5) a nonprofit that has an interest in real property that will be financially affected under the materiality standards for real property;[39] or (6) a business entity that will be financially affected under the materiality standards for business entities.[40]

Sale of personal or real property belonging to an official is material when the source is a claimant, applicant, respondent, contracting party, named party in proceeding or has interest in any business entity or real property that will be financially affected under the applicable materiality standards.[41]

A reasonably foreseeable financial effect on a person who is a source of income is material if the public official receives or is promised income to achieve a goal or purpose which the government decision could affect.[42]

4. Source of Gift

As with other sources of income, a financial effect on a source of gifts worth $460 or more in the prior 12 months[43] is material if the source is explicitly involved in a decision or if the source meets the materiality standards outlined above. A reasonably foreseeable financial effect of a government decision on a source of a gift to a public official is material if the source is: (1) a claimant, applicant, respondent, contracting party, or is otherwise named or identified as the subject of the proceeding; (2) an individual (including their immediate family) who will receive a measurable financial benefit or loss from a decision;[44] (3) an individual who has an interest in a business entity or real property that will be financially affected; (4) nonprofit that will receive a measurable financial benefit or has an interest in real property that will be financially affected under the materiality standards for real property; or (5) a business entity and the decision will have material effect under the materiality standards for business entities.[45]

5. Personal Financial Effect on Personal or Immediate Family's Finances

A personal financial effect of a governmental decision or his or her immediate family is material if the official or the official's immediate family member will receive any measurable financial benefit or loss from the decision.[46]

If, after applying the above standards, you determine that the financial effect is not material, there is no conflict of interest under the PRA. If, based on the relevant regulation, the financial effect is material, continue on to Step 3.

C. Step 3: Can the public official demonstrate that the material financial effect on the public official's financial interest is indistinguishable from its effect on the public generally?

The third step asks whether you can point to a specific person or a distinguishable group of people, organizations, or properties that will be effected like the involved official. To answer this question, you must apply FPPC Regulation 18703. First, consider whether the group is a significant segment of the public, i.e., at least 25 percent of all business or non-profits within the official's jurisdiction.[47] Then, you must analyze whether the effect on the involved official is unique or disproportionate[48] within the jurisdiction.[49] There are special rules for public services and utilities,[50] general use or licensing fees,[51] neighborhoods,[52] rental properties,[53] trade groups,[54] emergencies,[55] and governmental entities.[56]

If a governmental decision's financial effect on a public official's financial interest is indistinguishable from its effect on the public generally, there is no conflict of interest under the Act.[57] If the financial effect is distinguishable from the effect on the public generally, proceed to Step 4.

D. Step 4: Is the public official making, participating in making, or in any way attempting to use his or her official position to influence a governmental decision?

If you answered yes to the first three steps and no exception applies,[58] the public official cannot make, participate in making, or in any way attempt to use his or her official position to influence the governmental decision as defined in FPPC Regulation 18704.

An official makes a governmental decision if he or she authorizes or directs any action, votes, appoints a person, obligates or commits their agency to a course or action, or enters into an agreement on behalf of their agency.[59] If an official provides information, an opinion, or a recommendation for the purpose of affecting a decision without significant intervening substantive review, the public official is participating in a decision.[60] A public official can influence a governmental decision in two ways: (1) by contacting or appearing before their agency, any official in their agency or an agency subject to his/her authority or budgetary control to affect a decision, or (2) by purporting to represent their agency or act in their official capacity when contacting or appearing before any official in any other governmental agency to affect a decision.[61]

There are a number of exceptions to these definitions including ministerial actions, certain appearances as a member of the general public, and actions relating to a public official's terms or conditions of employment or compensation.[62]

III. DISQUALIFICATION REQUIREMENTS

If an official has a disqualifying conflict of interest, then the official must, immediately before consideration of the decision: (1) publicly identify the financial interest, (2) recuse himself or herself, and (3) leave the room.[63] A disqualified official must not attend any closed session during which the governmental decision is considered, and the official must not obtain or review any nonpublic information about the governmental decision.[64] In the case of staff, a disqualified staff member may not attend a closed session, obtain any confidential information from a closed session, or make or participate in making a decision in which they have a conflict of interest.[65]

Additionally, public attorneys should encourage public officials to seek advice from the FPPC because only the FPPC's advice can be used as a defense if the official's conduct or involvement is later challenged.[66]

IV. CONCLUSION

While the FPPC has reduced the total number of PRA regulations and eliminated the need to use a calculator in conflict analyses, these regulations are also more subjective than the rules they replaced. As a result, in applying the new regulations, public attorneys should pay attention to their internal ethics alarm to avoid even the appearance of a conflict of interest, and remember to analyze conflicts under all applicable laws, including Section 1090.

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Endnotes

1 *See* 2 Cal. Code Regs. §§ 18700-18707 (hereinafter referred to as "FPPC Regulations" collectively and "FPPC Regulation" singularly).

2 *See* Cal. Gov. Code § 87100; *see generally* Gov. Code §§ 81000-91014.

3 Gov. Code § 1090.

4 Gov. Code § 87100 *et seq.*; 2 Cal. Code Regs. § 18700(a); 2 Cal. Code Regs. § 18700(c)(6)(A-F)

5 2 Cal. Code Regs. § 18700(c)(6)(A).

6 2 Cal. Code Regs. § 18700(c)(6)(D); *see also* 2 Cal. Code Regs. § 18700.1.

7 2 Cal. Code Regs. § 18700(c)(6)(B).

8 2 Cal. Code Regs. § 18700(c)(6)(C).

9 2 Cal. Code Regs. § 18700(c)(6)(E).

10 12 Cal. Code Regs. § 18702.5(a).

11 2 Cal. Code Regs. § 18701(a).

12 2 Cal. Code Regs. § 18701(b).

13 *Id*.

14 2 Cal. Code Regs. § 18701(b)(1).

15 2 Cal. Code Regs. § 18701(b)(2).

16 2 Cal. Code Regs. § 18701(b)(3).

17 2 Cal. Code Regs. § 18701(b)(4).

18 2 Cal. Code Regs. § 18701(b)(5).

19 2 Cal. Code Regs. § 18701(b)(6).

20 2 Cal. Code Regs. § 18702(b).

21 2 Cal. Code Regs. § 18702.

22 2 Cal. Code Regs. § 18702.1.

23 2 Cal. Code Regs. § 18702.1(b).

24 2 Cal. Code Regs. § 18702.1(b)(1)-(6).

25 2 Cal. Code Regs. § 18702.2(a)(1), *but see* § 18702.2(c)(2) for limited exception.

26 2 Cal. Code Regs. § 18702.2(a)(2).

27 2 Cal. Code Regs. § 18702.2(a)(3).

28 2 Cal. Code Regs. § 18702.2(a)(4).

29 2 Cal. Code Regs. § 18702.2(a)(5).

30 2 Cal. Code Regs. § 18702.2(a)(6), *but see* § 18702.2(c)(1) for limited exception.

31 2 Cal. Code Regs. § 18702.2(a)(7)-(9).

32 2 Cal. Code Regs. § 18702.2(a)(10); *see also* FPPC Advice Letter A-15-118 (July 23, 2015).

33 2 Cal. Code Regs. § 18702.2(a)(11); *see also* FPPC Advice Letter A-15-101 (July 7, 2015).

34 2 Cal. Code Regs. § 18702.2(a)(12).

35 2 Cal. Code Regs. § 18702.2(b).

36 *See* FPPC Advice Letter A-15-013 (February 26, 2015) for a helpful example of a business entity that is a source of income. Note, this Article does not include a discussion of the Nexus test. For more information, see FPPC Regulation 18702.3(c).

37 2 Cal. Code Regs. § 18702.5.

38 See FPPC Advice Letter A-15-099 (July 27, 2015).

39 *See* FPPC Advice Letter A-15-099 (July 27, 2015).

40 2 Cal. Code Regs. § 18702.3.

41 2 Cal. Code Regs. § 18702.3.

42 2 Cal. Code Regs. § 18702.3.

43 2 Cal. Code Regs. §§ 18700(c)(6)(E) and 18702.4.

44 2 Cal. Code Regs. § 18702.5.

45 2 Cal. Code Regs. § 18702.4.

46 2 Cal. Code Regs. § 18702.5(a); *but see* exceptions listed in subparts (b) and (c).

47 2 Cal. Code Regs. § 18703(b).

48 2 Cal. Code Regs. § 18703(c).

49 2 Cal. Code Regs. § 18703(d).

50 2 Cal. Code Regs. § 18703(e)(1).

51 2 Cal. Code Regs. § 18703(e)(2).

52 2 Cal. Code Regs. § 18703(e)(3).

53 2 Cal. Code Regs. § 18703(e)(4).

54 2 Cal. Code Regs. § 18703(e)(5).

55 2 Cal. Code Regs. § 18703(e)(6).

56 2 Cal. Code Regs. § 18703(e)(7).

57 See FPPC Advice Letter A-15-126 (July 27, 2015) (applying public generally exception).

58 See FPPC Advice Letter A-15-133 (August 6, 2015) (applying legally required participation exception).

59 2 Cal. Code Regs. § 18704(a).

60 2 Cal. Code Regs. § 18704(b).

61 2 Cal. Code Regs. § 18704(c).

62 2 Cal. Code Regs. § 18704(d).

63 Gov. Code §87105.

64 2 Cal Code Regs. § 18707(2); *but see* exceptions in subpart (3).

65 2 Cal. Code Regs. § 18704.

66 Gov. Code § 83114(b).