

Admin.

January 7, 2000

Memorandum 2000-2

Conflict of Interest Disclosure and Disqualification Matters

The conflict of interest provisions of the Political Reform Act of 1974 (PRA) impose certain duties on Commissioners, the staff, and the Commission itself. This memorandum discusses two items relating to those duties:

(1) The Commission's Conflict of Interest Code, specifying the economic interests that Commission employees must disclose in a statement of economic interests, should be amended to encompass new areas of study undertaken by the Commission. Possible alternative approaches are discussed below.

(2) The Fair Political Practices Commission (FPPC) has substantially reorganized its regulations governing disqualification from governmental decisionmaking. The changes are briefly described below. The procedures that must be followed when disqualifying oneself are also described.

The following items are attached as an Exhibit:

	<i>Exhibit pp.</i>
1. California Law Revision Commission Conflict of Interest Code (last amended February 1996)	1
2. Executive Secretary's letter listing reportable financial interests (Feb. 4, 1999)	4
3. Revised Appendix D of CLRC Handbook of Practices and Procedures	6

All statutory references are to the Government Code.

CONFLICT OF INTEREST CODE

Statutory Requirements

Every agency subject to the PRA must adopt a Conflict of Interest Code enumerating the positions within the agency that involve making, or participating in the making of, decisions that may foreseeably have a material effect on any financial interest. For each enumerated position, the Code must enumerate the specific types of economic interests that are reportable. An economic interest is "reportable" if it "may foreseeably be affected materially by

any decision made or participated in by the designated employee by virtue of his or her position.” Section 87302(a).

The Commission’s Code

The Commission’s Conflict of Interest Code incorporates the model Conflict of Interest Code promulgated by the FPPC (2 Cal. Code Regs. § 18730) as well as an Appendix specifying the various classes of “designated employee” and the “disclosure categories” applicable to each class. See Exhibit pp. 1-3. Disclosure Category 1 (applicable to Commissioners and legal staff) requires the disclosure of:

1. Interests in real property.
2. Investments in listed business entities.
3. Personal income from listed entities or persons.
4. Business entity income from listed entities or persons.
5. Business positions in listed entities.

It then lists the entities and persons, within the jurisdiction of California, that foreseeably may be materially affected by a Commission decision concerning a topic on the Commission’s Calendar of Topics Authorized for Study.

The Executive Secretary’s Letter

Because the Commission’s active agenda changes over time, the list of entities and persons set out in Category 1 is supplemented by an annual letter prepared by the Executive Secretary and filed with the FPPC that specifies which of the entities and persons listed in Category 1 may be affected by an “active topic.” See Exhibit pp. 2, 4-5. Active topics are topics the Commission has considered during the preceding 12 months, or will consider during the following 12 months. The Executive Secretary’s letter can be used to narrow the reporting requirements of the Conflict of Interest Code, but cannot be used to expand them.

The Problem

The Commission has recently undertaken new studies (mechanics liens, common interest developments, criminal sentencing) that foreseeably might affect entities and persons not listed in Disclosure Category 1. In addition, our ongoing studies of mediation and health care decisionmaking appear to involve entities or persons that are not listed in Category 1 (mediators and health care providers). The Conflict of Interest Code should be amended to expand the scope of required disclosure.

Alternative Approaches

Two alternative approaches to amending the Conflict of Interest Code are described below:

(1) *Supplement the list.* One approach is to preserve the existing disclosure scheme and simply add new entities and persons to the list in Category 1. The disadvantage of this approach is its stop-gap nature. As new studies are undertaken in the future, the list will need to be further supplemented. Each change in the list involves amending a regulation — a cumbersome process. It would be better to find an approach that does not require periodic adjustments.

(2) *Switch to full disclosure.* The need for future adjustments to Category 1 could be eliminated by replacing the current scheme with a full disclosure requirement — employees subject to Category 1 would disclose all California investments, business positions, interests in real property, and income. This is consistent with the approach taken by the now defunct California Constitution Revision Commission and the “Little Hoover” Commission, agencies somewhat similar to the Law Revision Commission in the scope and nature of their responsibilities. A full disclosure requirement would also be considerably simpler to apply than our existing process.

The disadvantage of this approach is that it could result in disclosure of economic interests that have nothing to do with the Commission’s work, compromising the privacy of Commissioners and staff unnecessarily. On the other hand, it is historically a common practice for Commissioners to over-disclose voluntarily, in order to avoid the complexities of our existing scheme.

Recommendation

The staff favors the second approach. It would be much easier to administer and apply. The additional burden on privacy imposed by full disclosure should not be too great considering the fairly broad disclosure that is already required under the existing system. If the Commission concurs, the staff will start the process of amending the Conflict of Interest Code.

DISQUALIFICATION

The PRA prohibits self-interested decisionmaking by government officials. Section 87100 provides:

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.

This basic prohibition is elaborated in other sections of the PRA and in the FPPC regulations implementing the PRA. See Sections 87101 (legally required participation exception), 87103 (financial interest defined); 2 Cal. Code Regs. §§ 18700-18720 (implementing regulations).

Reorganized Regulations

The FPPC has substantially reorganized the regulations implementing the disqualification rules. The regulations are now organized to facilitate an eight-step method for analyzing whether a person is disqualified from making a particular decision under Section 87100. The eight-step method is summarized in Section 18700(b) of Title 2 of the California Code of Regulations.

The appendices to the Handbook of Practices and Procedures that address disqualification under the PRA will be revised to reflect the reorganization of the regulations. A draft of the revised Appendix D, summarizing the disqualification rules, is attached for reference.

Disqualification Procedure

There is a specific procedure that must be followed when an official is disqualified from making a governmental decision. It is worth reviewing that procedure. See 2 Cal. Code Regs. § 18730(b)(10):

When a designated employee determines that he or she should not make a governmental decision because he or she has a disqualifying interest in it, the determination not to act must be accompanied by disclosure of the disqualifying interest. In the case of a voting body, this determination and disclosure shall be made part of the agency's official record; in the case of a designated employee who is the head of an agency, this determination and disclosure shall be made in writing to his or her appointing authority; and in the case of other designated employees, this determination and disclosure shall be made in writing to the designated employee's supervisor.

Thus, it is not enough to simply abstain from participating in a decision in which one has a disqualifying interest. A Commissioner would also need to

disclose the existence of the conflict and the disqualifying interest, on the record.
A staff member would need to make the same disclosure, in writing.

Respectfully submitted,

Brian Hebert
Staff Counsel

CONFLICT OF INTEREST CODE
FOR THE
CALIFORNIA LAW REVISION COMMISSION
[as revised February 1996]

The Political Reform Act, Government Code Sections 81000, *et seq.*, requires state and local government agencies to adopt and promulgate Conflict of Interest Codes. The Fair Political Practices Commission has adopted a regulation, 2 Cal. Code of Regs. Section 18730, which contains the terms of a standard Conflict of Interest Code, which can be incorporated by reference, and which may be amended by the Fair Political Practices Commission to conform to amendments in the Political Reform Act after public notice and hearings. Therefore, the terms of 2 Cal. Code of Regs. Section 18730 and any amendments to it duly adopted by the Fair Political Practices Commission, along with the attached Appendix in which officials and employees are designated and disclosure categories are set forth, are hereby incorporated by reference and constitute the Conflict of Interest Code of the California Law Revision Commission.

Designated employees shall file statements of economic interests with their agency. Upon receipt of the statements of Commissioners and the Executive Secretary, the agency shall make and retain a copy and forward the original of these statements to the Fair Political Practices Commission. The agency will make all statements available for public inspection and reproduction. (Gov't Code § 81008.)

APPENDIX
DESIGNATED EMPLOYEES

<i>Designated Employees</i>	<i>Disclosure Categories</i>
Commission Member (appointed by Governor)	1, 2
Legislative Counsel	1, 2
Executive Secretary	1, 2, 3
Assistant Executive Secretary	1, 2, 3
Staff attorneys	1
Administrative Assistant	2, 3

DISCLOSURE CATEGORIES

CATEGORY 1

A designated employee in this category must disclose the following:

1. Interests in real property.
2. Investments in business entities listed below.
3. Personal income from entities or persons listed below.
4. Business entity income from entities or persons listed below.
5. Business positions in entities listed below.

The entities and persons listed below, in the jurisdiction of California, constitute financial interests of a type that foreseeably may be materially affected by a Law Revision Commission decision concerning a topic on the Commission's Calendar of Topics Authorized for Study:

1. Banks, savings and loan institutions, credit unions, and other financial institutions.
2. Mortgage brokers.
3. Collection agencies.
4. Any entities or persons whose primary activity in California is the making of secured or unsecured loans.
5. Any entities or persons whose primary activity in California is the sale, leasing, or development of real estate.
6. Any entities or persons whose primary activity in California is the leasing of personal property.
7. Insurance companies.
8. Public entities, so long as the income is not excluded by Government Code Section 82030(b)(2).
9. Title insurance companies.
10. Newspaper companies.
11. Corporate sureties.
12. Adoption agencies.
13. Persons engaging in private placing for adoption of more than one child per year.
14. Privately owned public utilities.
15. Law firms.
16. Any entities or persons engaged in the business of tracing heirs.
17. Any entities or persons engaged in the business of appraising property.
18. Any entity or person that is a party in unfair competition litigation in California or has been within the past two years.
19. A director of a California corporation.
20. An officer or director of a California unincorporated nonprofit association.

Financial interest on this list are reportable if they relate to active topics on the Commission's Calendar of Topics. Active topics are topics the Commission has considered during the 12 months preceding, or to be considered during the 12 months following, the end of the applicable filing period, and are determined from the Commission's Annual Report, as specified by the Executive Secretary in a letter filed at least annually with the Fair Political Practices Commission.

CATEGORY 2

A designated employee in this category must disclose business entities in which he or she has an investment or holds a business position and sources of income if the business entities or sources of income are of the type which within the previous two years contracted with the Law Revision Commission to provide leased space or consulting services to or on behalf of the Law Revision Commission.

CATEGORY 3

A designated employee in this category must disclose business entities in which he or she has an investment or holds a business position and sources of income if the business entities or sources of income are of the type which within the previous two years contracted with the Law Revision Commission to provide equipment, materials, supplies, or services (other than consulting services) to or on behalf of the Law Revision Commission.

CALIFORNIA LAW REVISION COMMISSION

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February 4, 1999

Fair Political Practices Commission
428 J Street, Suite 800
Sacramento, CA 95814

Re: Reportable financial interests for current filing period

This letter is filed with the Fair Political Practices Commission pursuant to the Conflict of Interest Code of the California Law Revision Commission, as revised February 1996. It supersedes my letter of January 28, 1998.

I have reviewed the Conflict of Interest Code list of entities and persons in the jurisdiction of California of a type that foreseeably may be materially affected by a Law Revision Commission decision concerning a topic on the Commission's Calendar of Topics Authorized for Study. I have also reviewed the list of active topics on the Law Revision Commission's Calendar of Topics that the Commission has considered during the twelve months preceding, and to be considered during the twelve months following, the end of the current filing period as determined from the Commission's *1998-1999 Annual Report*, 28 Cal. L. Revision Comm'n Reports 679 (1998).

From that review I specify the following entities and persons as reportable financial interests for the current filing period:

1. Banks, savings and loan institutions, credit unions, and other financial institutions.
2. Collection agencies.
3. Any entities or persons whose primary activity in California is the making of secured or unsecured loans.
4. Any entities or persons whose primary activity in California is the sale, leasing, or development of real estate.
5. Public entities, so long as the income is not excluded by Government Code Section 82030(b)(2).
6. Title insurance companies.
7. Newspaper companies.
8. Corporate sureties.
9. Privately owned public utilities.
10. Law firms.
11. Any entities or persons engaged in the business of tracing heirs.
12. Any entities or persons engaged in the business of appraising property.

13. A director of a California corporation.
14. An officer or director of a California unincorporated nonprofit association.

Sincerely,

Nathaniel Sterling
Executive Secretary

File: 3.7.3

Appendix D. Disqualification from Decision-Making

(last revised January 7, 2000)

Under the Political Reform Act of 1974, a public official is disqualified from participating in a governmental decision in which the official has a financial interest:

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.¹

However, this prohibition is subject to two important exceptions:

(1) An official does not have a disqualifying financial interest in a decision if the effect of the decision on the official's interest is indistinguishable from its effect on the public generally.²

(2) An official is not disqualified from governmental decisionmaking if the official's participation is legally required for the decision to be made.³

Several questions arise in applying these rules. What is a financial interest under this provision? When is the effect of a decision on an official's interest distinguishable from its effect on the public generally? When is an official's participation in a governmental decision legally required? This appendix provides general answers to these questions.

Financial Interest

A public official has a financial interest in a decision if it is reasonably foreseeable that the decision will have a material financial effect, distinguishable from its effect on the public generally, on any of the official's economic interests.⁴ The various elements of this rule are discussed below.

Reasonable foreseeability. The effect of a governmental decision is reasonably foreseeable if it is "substantially likely" that the decision will have the effect.⁵ This means a likelihood that is less than a certainty, but more than a mere possibility.⁶

1. Gov't Code § 87100. Note that the statutes and regulations cited in this Appendix are set out in Appendix C.

2. Gov't Code § 87103.

3. Gov't Code § 87101.

4. Gov't Code § 87103, 2 Cal. Code Regs. § 18700(a).

5. 2 Cal. Code Regs. § 18706.

6. See generally *In re Thorner*, 1 FPPC Ops. 198 (1975).

Economic interests. An official has economic interests in the following:

- (1) A business entity in which the official has a direct or indirect⁷ investment worth \$1,000 or more.⁸
- (2) Real property in which the official has a direct or indirect interest worth \$1,000 or more.⁹
- (3) A source of income aggregating \$250 or more in the 12 months prior to the decision being made.¹⁰ In determining sources of income, it is important to recall that a married official has a community property interest in his or her *spouse's* income. Thus, a source of income to a spouse may also be a source of income to the official. Similarly, if an official owns a 10% or greater interest in a business entity, a pro rata share of income to the business is considered income to the official.¹¹ Thus, the business' clients may be sources of income to the official.
- (4) A business entity in which the official is a director, officer, partner, trustee, employee, or holds any position of management.¹²
- (5) A source of gifts aggregating \$300 or more in value in the 12 months prior to the decision being made.¹³
- (6) The official's personal finances. A decision affects personal finances if it will result in an increase or decrease in the personal expenses, income, assets, or liabilities of the official or the official's immediate family. However, this does not include an effect on the value of real property or the gross revenues, expenses, or value of assets and liabilities of a business entity.¹⁴

Material effect. The materiality of an effect is determined by applying a number of highly detailed regulations. These regulations set out different materiality criteria for the different types of economic interests. These criteria also vary depending on whether the effect of the governmental decision on the economic interest is "direct" or "indirect." Direct effects are limited to such things as license hearings and zoning decisions, where the affected economic interest is the subject of the decision.¹⁵ The effect of most Commission decisions is indirect because the decisions involve statutes of general application. Unfortunately, the materiality criteria are too numerous and complex to usefully summarize. An official who

7. An official has an indirect investment or interest if the investment or interest is owned by the official's spouse, dependent child, or agent, or by a business entity or trust in which the official or the official's spouse, dependent child, or agent owns a 10 percent interest or greater. See the last paragraph of Government Code Section 87103.

8. 2 Cal. Code Regs. § 18703.1.

9. 2 Cal. Code Regs. § 18703.2.

10. 2 Cal. Code Regs. § 18703.3.

11. Gov't Code § 82030(a) ("income" defined).

12. 2 Cal. Code Regs. § 18703.1(b).

13. 2 Cal. Code Regs. § 18703.4.

14. 2 Cal. Code Regs. § 18703.5.

15. 2 Cal. Code Regs. § 18704-18704.5.

believes that a decision may affect the official's economic interests should review the relevant criteria in detail.¹⁶

The "public generally" exception. Even if a decision would have a reasonably foreseeable material financial effect on an official's economic interests, disqualification is not required if the effect is not "distinguishable from its effect on the public generally."¹⁷ A material financial effect is indistinguishable from its effect on the public generally if it affects the official's economic interest in *substantially the same manner* as it will affect a *significant segment* of the population in the official's jurisdiction.¹⁸ For the Commission, a significant segment of the population includes any of the following:

- (1) 10% of the population of California.
- (2) 10% of California property owners, home owners, or households.
- (3) 50% of all California businesses
- (4) 5,000 residents of California.
- (5) In exceptional circumstances, some other significant segment.

Considering that the Commission proposes general statutes of statewide application, most Commission decisions will fall within this exception.

Legally Required Participation

Even if an official has a financial interest in a decision, the official is not disqualified from participating in making that decision if the official's "participation is legally required for the action or decision to be made."¹⁹ However, this exception is narrowly construed.²⁰ An official's participation is not legally required "unless there exists no alternative source of decision consistent with the purposes and terms of the statute authorizing the decision."²¹

The question has arisen whether an official's participation is legally required in order to convene a quorum or to obtain the number of votes necessary to act. The regulations provide that the legally required participation exception shall

not be construed to allow a member of any public agency, who is otherwise disqualified under Government Code Section 87100, to vote if a quorum can be convened of other members of the agency who are not disqualified under Government Code Section 87100, *whether or not such other members are actually present at the time of the disqualification.*²²

16. See 2 Cal. Code Regs. § 18705-18705.5.

17. Gov't Code § 87103.

18. 2 Cal. Code Regs. § 18707.

19. Gov't Code § 87101.

20. 2 Cal. Code Regs. § 18708(c).

21. *Id.*

22. cite (emphasis added).

Thus the “legally required” standard is not satisfied if there is an absent member, even a habitually absent member, who is able to attend and make the quorum or if a vacancy exists that can be filled.²³ If there are *problems* in obtaining a quorum, rather than conditions where a quorum is *impossible*, the “legally required” standard is not satisfied.²⁴

If an otherwise disqualified public official participates in making a decision pursuant to the legally required participation exception, the official must:

- (1) Disclose as a matter of official public record the existence of the financial interest;
- (2) Describe with particularity the nature of the financial interest before he or she makes or participates in making the decision;
- (3) State the reason there is no alternative source of decision-making authority;
- (4) Participate in the decision only in an open meeting of the agency, as required by Government Code Sections 11123 and 54953, or in closed session, as provided in Government Code Sections 11126, 54956.7, 54956.8, 54956.9, 54957 and 54957.6, where participation by the official is legally required for the agency to act.²⁵

Disqualification Procedure

There is a specific procedure that must be followed when an official is disqualified from making a governmental decision:

When a designated employee determines that he or she should not make a governmental decision because he or she has a disqualifying interest in it, the determination not to act must be accompanied by disclosure of the disqualifying interest. In the case of a voting body, this determination and disclosure shall be made part of the agency’s official record; in the case of a designated employee who is the head of an agency, this determination and disclosure shall be made in writing to his or her appointing authority; and in the case of other designated employees, this determination and disclosure shall be made in writing to the designated employee’s supervisor.²⁶

Thus, it is not enough to simply abstain from participating in a decision in which one has a disqualifying interest. A Commissioner must disclose the existence of the conflict and the disqualifying interest, on the record. A staff member would need to make the same disclosure, but in writing.

23. See, e.g., Cohen Advice Letter No. A-94-274.

24. See, e.g., Dorsey Advice Letter No. A-92-089 (councilmember’s participation was legally required to achieve a quorum where another member was medically incapacitated and no alternative source of decision existed).

25. 2 Cal. Code Regs. § 18701(b).

26. 2 Cal. Code Regs. § 18730(b)(10).