Admin. March 7, 2000

Memorandum 2000-20

Conflict of Interest Disclosure

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

(1) The extent to which an official must disclose the business clients of an official's spouse in a statement of economic interests.

(2) The need to amend the Commission's Conflict of Interest Code.

The following items are attached as an Exhibit:

All statutory references are to the Government Code.

DISCLOSURE OF SPOUSE'S BUSINESS CLIENTS

At its February meeting, the Commission instructed the staff to determine the extent to which business clients of an official's spouse must be disclosed on the official's statement of economic interests. Specifically, where an official's spouse owns a 10% or greater share in a law firm, must the official disclose the clients of the firm *as sources of income to the official*? This question can be broken down into a series of intermediate questions: (1) When is disclosure of a spouse's business clients required? (2) Is there a duty to inquire about a spouse's clients if they are not actually known to an official? (3) Does required disclosure of an attorney's clients violate the attorney-client privilege? (4) Does required disclosure of an attorney's clients violate protected privacy rights?

Disclosure of Spouse's Business Clients Required Above a Certain Payment Threshold

An official's "income" includes any community property interest in income of a spouse. Section 82030. "Income" includes a pro rata share of any income of a business entity in which the official or the official's spouse owns a 10% or greater interest. *Id.* A statement of economic interests must disclose a source of income to such a business if the official's pro rata share of that income is $10,000 or greater in a calendar year. Section 87207(b). Thus, if the official's spouse is sole proprietor of a business, the official has a 50% community property share of any income received by that business, and must therefore disclose any clients who paid the business $20,000 or more during the calendar year. If the spouse's ownership interest in the business is smaller, then the official's pro rata share of any income to the business is also smaller, and the threshold payment requiring disclosure is correspondingly larger. For example, if an official's spouse owns a 50% interest in a business, then a client must pay $40,000 in a calendar year to meet the minimum for required disclosure — the spouse's 50% share of $40,000 is $20,000 and the official's community property share of $20,000 is $10,000.

The foregoing assumes that the official has a community property interest in income of the official's spouse. If the spouse's income is separate property, then it is not reportable as a source of income to the official. See discussion in FPPC Advice Letter No. A-99-246(a).

All Reasonable Diligence Required in Discovering Sources of Income

As a practical matter, an official can only disclose a source of income if the official knows that the source of income exists and that the amount of income from that source meets or exceeds the statutory minimum for disclosure. If the source of income is a business client of the official's spouse, the official may not know of the client's existence or the amount of the client's payments. This is especially likely where the spouse is a lawyer or other professional whose services are expected to involve confidentiality. In fact, an official's spouse may refuse to disclose client information to the official. What is the official's duty where client information is unknown or unavailable to the official?

In the Christiansen Advice Letter (I-87-019 (1987)), the Fair Political Practices Commission (FPPC) was asked whether a city council member must disclose the clients of her husband's accounting partnership on her statement of economic interests if he is unwilling to disclose that information due to the confidential

nature of his business. The FPPC advised Ms. Christiansen that she must disclose any of her husband's clients who contributed $40,000 or more to his business in the reporting period (her husband had a half interest in the business, so his pro rata share of $40,000 is $20,000 and her community property share of $20,000 is $10,000). However, the FPPC also approved a novel scheme for determining which of her husband's clients were sources of income to her that might require disqualification from decisionmaking — Ms. Christiansen would submit to her husband a list of those persons who were scheduled to appear before the city council and he would tell her whether any of them were clients whose payments exceeded the threshold for disqualification. Ms. Christiansen would never need to see the full client list. FPPC's approval of this scheme seems inconsistent with its conclusion that Ms. Christiansen was required to disclose her husband's clients as sources of income on her statement of economic interests.

The apparent inconsistency in the Christiansen letter was resolved in 1995, when the FPPC expressly superseded its previous advice on spousal reluctance to disclose sources of income. See Commission Advice Regarding Disclosure of Community Property Interest in Spouse's Income (M-95-213 (1999)), which reads, in its entirety, as follows:

> The Christiansen Advice Letter, I-87-019, states in part that a spouse's reluctance to disclose sources of income may excuse the official from his or her reporting obligations regarding the community property interest in that income. This advice is no longer valid.
>
> A public official has a duty under the Act to report all sources of income in excess of [the threshold amount], including the community property interest in the income of a spouse. A spouse's refusal to provide the information necessary for disclosure does not excuse non-compliance with the Act's requirements.

This suggests that an official must somehow disclose business clients of a spouse that meet the minimum income reporting threshold, *even if the spouse refuses to disclose the information*.

However, it appears that an official is not actually required to disclose information that the official does not have. Instead, "all reasonable diligence" must be used in preparing a statement of economic interests. See Section 81004(a). In the Moores Advice Letter (A-99-264 (1999)), the FPPC was asked what an official should do if a company in which the official owns more than a 10% interest refuses to disclose its client information to the official. The FPPC

advised the official to document his attempts to obtain the information. Such documentation would include his letter to the company requesting the information, the company's response, as well as documentation that he had reviewed the company's website and its most recent Annual Report. The implication is that documentation of reasonably diligent, though unsuccessful, efforts to obtain the information would satisfy the disclosure requirements.

The foregoing suggests that where an official does not have actual knowledge of the business clients of the official's spouse, the official must exercise all reasonable diligence to obtain that information. If the official's spouse does not cooperate, out of concern for client confidentiality or privacy, the official must document the official's efforts to obtain the information, but is not required to disclose information that cannot be obtained. This is consistent with informal advice recently received from the FPPC technical assistance staff.

Identity of Clients Who Paid Threshold Amount Generally Not Protected By Attorney-Client Privilege

The FPPC has created a procedure for nondisclosure of client names where disclosure of a person's name would violate a "legally recognized privilege." See 2 Cal. Code Regs. § 18740. However, in *Hays v. Wood*, 25 Cal. 3d 772 (1979), the California Supreme Court held that requiring an attorney-official to disclose on his statement of economic interests the names of his clients who had paid the threshold amount for disclosure did not violate the attorney-client privilege. "It is well established that the attorney-client privilege, designed to protect communications between them, does not ordinarily protect the client's identity." Of course, disclosure of a client on a statement of economic interests does more than just reveal the client's identity — it also discloses the fact that the client paid more than the threshold amount of fees in a calendar year (but not the exact amount of the fees paid). The court did not specifically address this point, but it was well aware that disclosure is only required for sources of income above the threshold. Furthermore, there are cases holding that disclosure of a client's identity *and fee arrangements* does not violate the attorney-client privilege. See, e.g., *Willis v. Superior Court*, 112 Cal. App. 3d 277, 299 (1981) ("In connection with the identity exception to the attorney-client privilege, many courts have held that the nature of the attorney's fee arrangements with his client, in an appropriate case, is not absolutely protected by the ambit of the privilege.").

There is a limited exception to the rule that a client's identity is not protected by the attorney-client privilege where disclosure of the client's identity might implicate the client in unlawful activities and could lead to official investigation or criminal or civil liability. *Hays v. Wood*, 25 Cal. 3d at 785. If an official believes that disclosure of the identity of a spouse's client would fall within the exception, the official should pursue the FPPC procedure for nondisclosure of privileged information.

Although *Hays v. Wood* involved disclosure by an attorney-official of the names of his own clients, it seems likely that the same principle would apply to the disclosure of the identity of an official's spouse's clients — only attorney-client communications, and not the *identity* of clients, are protected by the privilege.

Disclosure of Client Names Does Not Violate Protected Privacy Rights

In *Hays v. Wood*, the court also held that requiring disclosure of client identities on a statement of economic interests does not unconstitutionally intrude into protected zones of privacy (*Id.* at 783 (citation omitted)):

> On the contrary, we believe that inquiry into actual sources bears a demonstrable relation to the substantial governmental interests here involved.... It is after all the clients or customers of a business entity in which a public official has a substantial interest who present the greatest potential source of conflicting obligations and interests. Defendant and amici fail to persuade us that practical alternative means exist whereby the true sources of potential conflicts of interest may be revealed. Acknowledging, as we do, the public interest in avoiding such conflicts, and balancing that interest against the intrusion on recognized private rights, we do not find the statute invalid on grounds that it requires disclosure of the actual source of business income. As we noted in *Nevada*, "neither the right to privacy, nor the right to seek and hold public office, must inevitably prevail over the right of the public to an honest and impartial government."
>
> The foregoing discussion has focused essentially on the public official's constitutional rights to privacy. Much of it has equal application, however, to the corresponding privacy rights of disclosed clients and customers. While the client or customer may not himself be in the public arena, his business or professional relationship with the official may well give rise to the opportunities for divided loyalties and a resulting potential for improper influence over the conduct of public affairs. Thus, again viewing the matter solely from the standpoint of unwarranted invasion of

> privacy, we conclude that the same considerations of public interest which we have previously recognized as justifying limited disclosure by the affected official also support the reciprocal but limited invasion of client or customer privacy.

Again, *Hays v. Wood* involved disclosure by an attorney-official of the names of his own clients, rather than the clients of a spouse. It would seem that disclosure of a spouse's clients is more disruptive of the clients' expectations of privacy than disclosure of one's own clients. A person who conducts business with a public official probably knows that the person is an official and may realize that the person's business relationship to the official will be publicly disclosed. A person who conducts business with the spouse of an official may not understand that the person's business relationship with the spouse will be publicly disclosed. One could therefore argue that *Hays v. Wood* should be limited to its facts. However, the risk of conflicting obligations arising from the business clients of a spouse of an official is real, and it isn't clear how the risk of those conflicts could be exposed without requiring disclosure of a spouse's clients. It seems likely that the court's argument, quoted above, would apply equally to disclosure of a spouse's clients.

Note that *Hays v. Wood* discusses only constitutional privacy rights. It does not consider whether disclosure of a spouse's client's identity would violate any statutory right of privacy. However, the staff's research did not reveal any statutory privacy right that would be implicated in disclosure of an attorney's client's identity or approximate amount of fees paid.

Conclusion

If an official's spouse owns 10% or more of a business, sources of income to that business are also sources of income to the official. If the official's pro rata share of such income is $10,000 or more in a calendar year, the official must disclose the source of income on a statement of economic interests. In general, the fact that the sources of income are clients of a spouse's law practice does not affect this obligation (there is a narrow exception where disclosure of a client's identity violates the attorney-client privilege, discussed above). However, if, despite the official's efforts to obtain information regarding the business clients of the official's spouse, the information is unavailable, documentation of the official's unsuccessful efforts probably satisfies the requirement of "all reasonable diligence" in preparing a statement of economic interests.

Statutory Requirements

Every agency subject to the Political Reform Act 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 only be used to *narrow* the reporting requirements of the Conflict of Interest Code. It cannot be used to expand them.

The Problem

The Commission has recently undertaken new studies (e.g., mechanic's liens, 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 will need to 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 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, unnecessarily compromising the privacy of Commissioners and staff, and persons who are sources of income to Commissioners and staff. On the other hand, it is historically a common practice for Commissioners to over-disclose voluntarily.

Consequences of Alternatives With Respect to Disclosure of Business Clients of Spouse

As discussed above, an official must disclose clients of a spouse's business if the spouse owns 10% or more of the business and the official's pro rata share of the client's payments to the business is $10,000 or more in a calendar year. If we move to full disclosure, then Commissioners and staff will need to disclose all such clients of a spouse's business. Continuing our existing approach, with necessary adjustments, would minimize the intrusion into the privacy of a spouse's clients, because fewer clients would need to be reported. However, the official would need to determine, for each of the spouse's clients, whether they fall into one of the groups specified in Disclosure Category 1, as modified by the executive secretary's letter — a potentially difficult process.

Conclusion

The full disclosure alternative is easier to administer than our current enumeration of foreseeably affected persons. It does not require periodic amendments to the Conflict of Interest Code, as new studies are undertaken. Nor does it require annual issuance of a narrowing list, as studies drop off our calendar or become inactive. Furthermore, it might be easier to prepare a statement of economic interests by listing all economic interests, including any business clients of a spouse who have paid the threshold amount, rather than by determining for each economic interest whether it falls into one of the categories listed in our Code.

Balanced against this greater efficiency is the greater intrusiveness of full disclosure. Full disclosure could require disclosure of economic interests that have no arguable connection to the Commission's work. Our present scheme is not perfect in defining classes of persons who may foreseeably be materially affected by a Commission decision, but it is much more discriminating than a full disclosure scheme would be.

Once the Commission decides which approach to take, the staff will begin preparing an appropriate amendment to our Conflict of Interest Code.

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

Designated Employees	*Disclosure Categories*
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.

STATE OF CALIFORNIA

CALIFORNIA LAW REVISION COMMISSION
4000 MIDDLEFIELD ROAD, ROOM D-1
PALO ALTO, CA 94303-4739
650-494-1335

January 13, 2000

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 February 4, 1999.

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 *1999-2000 Annual Report*.

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