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MEMORANDUM OF LAW

DATE: June 11, 2015 (Revised)

TO: Honorable Mayor and Councilmembers

FROM: City Attorney

SUBJECT: Application of Recent Amendments to the Fair Political Practices
Commission Regulations Regarding a Material Effect on Real Property and
the Public Generally Exception

INTRODUCTION

Public officials, as defined, are prohibited from making, participating in, or attempting to influence a governmental decision in which they have a financial interest. Cal. Gov't Code § 87100. The California state body of law regarding the financial interests of public officials is the Political Reform Act (PRA). Cal. Gov't Code §§ 81000 - 91014. The City of San Diego's Ethics Ordinance also prohibits City officials, as defined, from participating in decisions in which the official has a financial interest. San Diego Municipal Code (SDMC), Chapter 2, Article 7, Division 35. These provisions are to be interpreted consistent with the PRA provisions, and are incorporated into the City's Ethics Ordinance by reference. SDMC § 27.3561(c).

Generally, a public official has a prohibited conflict of interest in making, participating in making, or attempting to influence a governmental decision if the decision will have a reasonably foreseeable material financial effect on one or more of the official's financial interests, unless the effect is indistinguishable from the effect on the public generally. Cal. Gov't Code § 87103. There are six disqualifying types of financial interests: investments in business entities, interests in real property, sources of income, sources of gifts, positions in business entities, and personal finances. Cal. Gov't Code § 87103(a)-(e). Any conclusion as to whether an individual is in violation of the PRA requires a multi-step analysis determining whether: (1) the members are public officials; (2) the public officials are making or participating in making a governmental decision; (3) the public officials have one of the six disqualifying financial interests listed above; (4) the governmental decision will have a material financial effect on the public officials' financial interest; and (5) the material effect on the public officials' financial interest is reasonably foreseeable. In addition, even if the public official has a disqualifying financial interest, he or she may still participate if the effect of the governmental decision on the public official's financial interest is indistinguishable from its effect on the general public or the public official's participation is legally required. Cal. Gov't Code §§ 87101, 87103 (the

exception for legally required participation does not include participation needed to break a tie vote).

The PRA establishes the Fair Political Practices Commission (FPPC) as the entity primarily responsible for the impartial, effective administration and implementation of the PRA. Cal. Gov't Code § 83111. The FPPC is authorized to adopt regulations to carry out the provisions of the PRA. Cal. Gov't Code § 83112. In 2013, the FPPC began a multi-year, multi-step process to reduce the steps of a conflict analysis to four. FPPC Staff Report at 1 (Feb. 6, 2015). Under the reduced process, to determine whether a financial conflict of interest exists when making a governmental decision, a public official must determine whether: (1) the financial effect is reasonably foreseeable; (2) the financial effect is material; (3) the financial effect is the same as the effect on the public generally; and (4) the official is making, participating in making, or using his or her position to influence a governmental decision resulting in a financial effect. *Id.*

In 2014, the FPPC adopted amendments to the regulations regarding the circumstances under which a governmental decision regarding real property is material. Cal. Code Regs., title 2 § 18702.2. On April 16, 2015, the FPPC also amended the regulations regarding the “public generally” exception. Cal. Code Regs., title 2 § 18703.¹ This memorandum provides an overview of the law in these areas and is not intended to provide specific advice pertaining to any particular public official or factual situation. Reliance on the City Attorney’s opinion does not insulate the public official from legal liability. A formal opinion from the Ethics Commission or FPPC protects the official from enforcement by the Ethics Commission or FPPC, respectively. SDMC § 26.0414(b); Cal. Gov't Code § 83114(b).

QUESTIONS PRESENTED

1. What is the effect of the recent amendments to the FPPC regulations regarding a material effect on real property?
2. What is the effect of the recent amendment to the FPPC regulations regarding the “public generally” exception to the participation of an otherwise disqualified public official?

SHORT ANSWERS

1. A financial interest in real property is no longer analyzed as either direct or indirect; the analysis is whether the financial effect on the public official’s financial interest is material.
2. The “public generally” exception for financial interests in real property is no longer analyzed pursuant to factors based largely on numerous mathematical calculations regarding what constitutes the significant segment of the public or the characteristics of real property. The 2015 FPPC amendments allow an otherwise disqualified public official to participate in the governmental decision if a significant segment of the City will be affected by

¹ These amendments will be final on June 17, 2015, 30 days after the filing on May 18, 2015 with the Secretary of State. Cal. Code Regs., title 2, §18312(e)(1).

the decision, so long as the decision does not have a disproportionate effect on the public official's interest, compared to a significant segment of the public.

ANALYSIS

I. AMENDMENTS REGARDING A MATERIAL EFFECT ON REAL PROPERTY

Although the pertinent recent FPPC regulatory amendments relate to the issue of the materiality of the financial effect on the public official, a brief review of all of the steps is presented.

Step One: Public Officials

The PRA applies to public officials; these are government officers, members, employees, and in certain circumstances, consultants. Cal. Gov't Code §§ 82019, 82048; Cal. Code Regs., title 2 § 18701. The definition of "member" includes unsalaried committee members with final decision-making authority. Cal. Code Regs., title 2 § 18700(c).

Step Two: Public Officials Make, Participate in Making, and Influence Governmental Decisions

The duties of public officials include making, participating in making, or attempting to influence a governmental decision.² Voting on an item, or deciding not to vote on an item (unless the official has recused due to a financial conflict of interest), is considered "making a governmental decision." Cal. Code Regs., title 2 § 18704.1. "Participating in making a governmental decision" occurs when public officials, acting within the authority of their position, negotiate contracts, advise, or make recommendations to the decision maker by conducting research or investigations requiring the exercise of judgment, the purpose of which is to influence a governmental decision involving the:

- (1) Approval of a rate, rule, or regulation;
- (2) Adoption or enforcement of a law;

² Making, participating in making, or influencing a governmental decision does not include actions by public officials which are solely ministerial, secretarial, manual, or clerical; appearances by the public official as a member of the public to represent him or herself on personal interests (limited to those matters concerning an interest in real property owned by the public official or his or her immediate family, a business entity wholly owned by the public official or his or her immediate family or over which the public official exercises sole direction and control, or over which the public official and his or her spouse jointly exercise sole direction and control); actions relating to compensation or terms of employment; communication with the general press or public; the preparation or submission of architectural, engineering, or similar materials to be used by a client (however, the public official may not have any other written or oral contact with the agency, except as is necessary to process or evaluate that material); appearance before a design or architectural review committee of which the public official is a member to present that material if: the committee's sole function is to make recommendations, the relevant law requires the committee to consist of architects, engineers, and persons in related professions, and the public official is a sole practitioner; or the participation in academic decisions regarding the selection of course materials, course selection and scholarship applications for the public official personally if that official has teaching or research responsibilities at an institution of higher education, or if any contract funding from a nongovernmental entity is reviewed by an independent committee within the institution. Cal. Code Regs., title 2 § 18704.4.

- (3) Issuance, denial, suspension, or revocation of any permit, license, application, certificate, approval, order, or similar authorization or entitlement;
- (4) Authorization of the agency to enter into, modify, or renew a contract provided it is the type of contract that requires agency approval;
- (5) Approval of a contract that requires agency approval and to which the agency is a party, or to the specifications for such a contract;
- (6) Approval of a plan, design, report, study, or similar item; or
- (7) Adoption or approval of, policies, standards, or guidelines for the agency, or for any subdivision thereof.

Cal. Code Regs., title 2 § 18704.2. Participating in making a governmental decision also includes the presentation of a report, analysis, or opinion which required the exercise of judgment, the purpose of which is to influence a governmental decision. *Id.*

Step Three: A Financial Interest in Real Property Is Assumed for the Purposes of this Analysis

Whether a public official has any of the various types of financial interests that are subject to the PRA is a fact-specific inquiry. This memorandum outlines the updated rules for the interests in real property. An “interest in real property” is defined “as any leasehold, beneficial or ownership interest or an option to acquire such an interest in real property located in the jurisdiction owned directly, indirectly or beneficially by the public official, or other filer, or his or her immediate family, including a registered domestic partner, if the fair market value of the interest is two thousand dollars (\$2,000) or more.” Cal. Gov’t Code § 82033. Interests in real property of an individual “includes a pro rata share of interests in real property of any business entity or trust in which the individual or immediate family owns, directly, indirectly or beneficially, a 10-percent interest or greater.” *Id.*

Step Four: The Financial Effect on a Public Official’s Interest in Property will Be Determined to Be Material if the Governmental Decision Involves or Affects the Public Official’s Property

Prior to the 2014 FPPC amendments, governmental decisions regarding real property were divided into two types: direct interests and indirect interests. Cal. Code Regs., title 2 § 18704.2 (repealed May 31, 2014). The inquiry then went on to the next step: determining whether the direct or indirect interest was material, applying respectively different materiality standards. *Id.* The 2014 FPPC amendments have deleted the step of determining whether the interest in real property is direct or indirect in favor of analysis of the materiality of the effect. Cal. Code Regs., title 2 § 18702.2.³

Pursuant to the 2014 FPPC amendment, the financial effect of a public official’s governmental decision regarding real property (other than a leasehold interest, which is discussed below) is material whenever that decision:

³ Notwithstanding the regulations discussed further below, the financial effect of a governmental decision is not material if it is “nominal, inconsequential, or insignificant.” Cal. Code Regs., title 2 § 18702.

- (1) Involves the adoption of or amendment to a general (except as provided below) or specific plan, and the public official's property is located within the proposed boundaries of that plan;
- (2) Zones or rezones the public official's property (other than a zoning decision applicable to all properties designated in that category), annexes or de-annexes property, or includes in or excludes from any city, county, district, or other local government subdivision, or other boundaries (other than elective district boundaries as determined by the California Citizen's Redistricting Commission or any other agency where the governmental decision is to determine boundaries for elective purposes);
- (3) Imposes, repeals, or modifies any taxes, fees, or assessments that apply to the public official's property;
- (4) Authorizes the sale, purchase, or lease of the public official's property;
- (5) Involves the issuance, denial or revocation of a license, permit or other land use entitlement authorizing a specific use of or improvement to the public official's property or any variance that changes the permitted use of, or restrictions placed on, that real property;⁴
- (6) Involves construction of, or improvements to, streets, water, sewer, storm drainage or similar facilities, and the parcel in which the public official has an interest will receive new or improved services that are distinguishable from improvements and services that are provided to or received by other similarly situated properties in the public official's jurisdiction or where the public official will otherwise receive a disproportionate benefit or detriment by the decision;
- (7) Changes the development potential of the public official's property;
- (8) Changes the income producing potential of the public official's property;⁵
- (9) Changes the highest and best use of the public official's property;
- (10) Changes the character of the public official's property by substantially altering traffic levels or the intensity of use, including parking, of property surrounding the public official's property, the view, privacy, noise levels, or air quality, including odors, or any other factors that would affect the market value of the public official's property;
- (11) Affects any real property value located within 500 feet of the property line of the public official's property (a public official may request that the FPPC provide written advice allowing the official to participate if the FPPC determines that there are sufficient facts to demonstrate that there will be no reasonably foreseeable measurable impact on the official's property);⁶ or
- (12) Would cause a reasonably prudent person, using due care and consideration under the circumstances, to believe that the governmental decision was of such a nature

⁴ If the financial effect of the decision regarding property is to the public official's business entity, the materiality of that decision will be analyzed pursuant to California Code of Regulations title 2, section 18702.1. (Materiality Standards: Financial Interests in Business Entities), rather than section 18702.2.

⁵ If the property contains a business entity, including rental property, which remains unchanged, the materiality of that decision will be analyzed pursuant to California Code of Regulations title 2, section 18702.1 rather than section 18702.2.

⁶ Except for commercial property containing a business entity, in which case the materiality of that decision will be analyzed pursuant to California Code of Regulations title 2, section 18702.1, rather than section 18702.2.

that its reasonably foreseeable effect would influence the market value of the public official's property.

Cal. Code Regs., title 2 § 18702.2(a).

The financial effect of a public official's governmental decision regarding any real property in which the official has a leasehold financial interest is material whenever that decision:

- (1) Changes the termination date of the lease;
- (2) Increases or decreases the potential rental value of the property;
- (3) Increases or decreases the rental value of the property, and the public official has a right to sublease the property;
- (4) Changes the public official's actual or legally allowable use of the property; or
- (5) Impacts the public official's use and enjoyment of the property.

Cal. Code Regs., title 2 § 18702.2(b).

However, the financial effect of governmental decisions regarding real property may be determined not to be material under any of the following circumstances:

- (1) The decision solely concerns repairs, replacement or maintenance of existing streets, water, sewer, storm drainage or similar facilities.
- (2) The decision solely concerns the adoption or amendment of a general plan *and* all of the following apply:
 - (A) The decision only identifies planning objectives or is otherwise exclusively one of policy. A decision will not qualify under this subdivision if the decision is initiated by the public official, by a person that is a financial interest to the public official, or by a person representing either the public official or a financial interest to the public official.
 - (B) The decision requires a further decision or decisions by the public official's agency before implementing the planning or policy objectives, such as permitting, licensing, rezoning, or the approval of or change to a zoning variance, land use ordinance, or specific plan or its equivalent.
 - (C) The decision does not concern an identifiable parcel or parcels or development project. A decision does not "concern an identifiable parcel or parcels" solely because, in the proceeding before the agency in which the decision is made, the parcel or parcels are merely included in an area depicted on a map or diagram offered in connection with the decision, provided that the map or diagram depicts all parcels located within the agency's jurisdiction and economic interests of the official are not singled out.
 - (D) The decision does not concern the agency's prior, concurrent, or subsequent approval of, or change to, a permit, license, zoning designation, zoning variance, land use ordinance, or specific plan or its equivalent.

Cal. Code Regs., title 2 § 18702.2(c) (emphasis added). In addition, a public official is not considered to have a financial interest in any common area as part of the public official's ownership interest in a common interest development. Cal. Code Regs., title 2 § 18702.2(d).

Step Five: It Is Reasonably Foreseeable that there will Be a Financial Effect on the Public Official's Interest in the Property if the Governmental Decision Is about the Public Official's Property, or if the Financial Effect Is a Realistic Possibility and Not Hypothetical and Theoretical

If the financial interest, i.e., the real property, is a named party in, or the subject of the governmental decision that is before the City, then it is presumed to be reasonably foreseeable that the public official's financial interest will be materially affected. Cal. Code Regs., title 2 § 18701. For example, a financial interest is the subject of a governmental decision when the governmental decision involves the issuance, renewal, or revocation of a permit to the financial interest. Cal. Code Regs., title 2 § 18701(a). Generally, if a financial effect is a "realistic possibility and more than hypothetical and theoretical, it is reasonably foreseeable." Cal. Code Regs., title 2 § 18701(b). If the financial effect would not occur without extraordinary circumstances beyond the public official's control, then the result is not reasonably foreseeable. *Id.*

Some relevant factors in considering whether it is reasonably foreseeable that the financial interest would be materially affected are: how contingent the financial effect is on intervening events other than any City decisions, whether the financial effect is a potential outcome under normal circumstances using appropriate due diligence and care; whether the financial interest is the type that would typically be affected by the governmental decision or 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; whether a reasonable inference can be made that the financial effects of the governmental decision on the public official's financial interest could compromise the public official's ability to act in a manner consistent with his or her duty to act in the best interests of the public; whether the governmental decision will provide or deny an opportunity, or create an advantage or disadvantage for one of the public official's financial interests, including whether the financial interest may be entitled to compete or be eligible for a benefit resulting from the decision; and 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 his or her financial interest in formulating a position. *Id.*

II. AMENDMENTS REGARDING THE "PUBLIC GENERALLY" EXCEPTION

Notwithstanding a conclusion that a disqualifying financial interest exists, if the effect of the governmental decision on a public official's financial interest in property is not distinguishable from that of the public's generally, then the public official is not required to recuse. Cal. Gov't Code § 87103; Cal. Code Regs., title 2 § 18700.

Pursuant to the 2015 FPPC amendments to the "public generally" regulations, the effect of a governmental decision on a public official's financial interest is indistinguishable from its

effect on the public generally if the public official can establish that a “significant segment of the public” is affected and the effect on the public official’s financial interest is not unique in comparison. Cal. Code Regs., title 2 § 18703(a). A “significant segment of the public” for the purposes of a decision by City official is at least 25 percent of: (1) all businesses or nonprofit entities within the City; (2) all real property, commercial or residential, within the City; or (3) all individuals in the City. Cal. Code Regs., title 2 § 18703(b).

A “unique effect” on a public official’s financial interest includes a disproportionate effect on: (1) the development potential or use of a public official’s real property, or on the income producing potential of that real property or business entity; (2) a public official’s business entity or real property, resulting from the proximity of a project that is subject to a public official’s decision; (3) a public official’s interests in business entities or real properties resulting from a cumulative effect of the public official’s multiple interests in similar entities and properties that is substantially greater than the effect on a single interest; (4) a public official’s interest in a business entity or real property, resulting from the public official’s substantially greater business volume or larger property size, when a decision affects the interests by the same or similar percentage; (5) a person’s income, investments, assets or liabilities, or real property if that person is a source of income or gifts to the public official; or (6) a public official’s personal finances, or those of his or her immediate family. Cal. Code Regs., title 2 § 18703(c).

There are exceptions to the above rules regarding whether an effect is distinguishable from the public generally. Cal. Code Regs., title 2 § 18703(e). Those exceptions that may be relevant to the public official’s duties and financial interests in property are:

- (1) The decision affects the public official’s personal finances as a result of an increase or decrease to a general fee or charge (such as parking rates, license or application fees, or any general fee) that applies to the City as a whole.
- (2) The decision affects residential real property, is limited to a specific location, and establishes, amends, or eliminates ordinances that restrict on-street parking, impose traffic controls, deter vagrancy, or reduce nuisances or improve public safety, if the body making the decision gathers sufficient evidence supporting the need for the action at that location.
- (3) The decision affects all renters of residential real property in the City of San Diego and only interests resulting from a public official’s leasehold in his or her residence are affected.

Cal. Code Regs., title 2 § 18703(e)(2)-(4).⁷

⁷ The other exceptions in the public generally regulation apply when: (1) the decision establishes or adjusts assessments, taxes, or fees, or rates for water, utility, or other similar public services that are applied equally or by the same percentage to the official’s interests and all businesses, properties, or individuals subject to that assessment, tax, fee, or rate; (2) the board or commission is required by law to have appointees from certain industries, trades, or professions and the public official represents that industry, trade or profession and the effect is only on that represented industry, trade, or profession, without a unique effect on the official’s interest; or (3) the governmental decision is required to mitigate the direct effects of a declared state of emergency and there is no unique effect on the official’s interest. Cal. Code Regs., title 2 § 18703(e)(1),(5)-(6).

CONCLUSION

To avoid a violation of the PRA as it pertains to financial interests in real property, public officials must bear in mind their individual property ownership, leasehold interests, or business entity interests, and consider whether they have any financial interest in real property as set forth in the PRA.⁸ Next, each public official should consider whether the financial interest is material, and if so, whether an exception to the materiality standard applies. Each public official should then determine whether it is reasonably foreseeable that there would be a financial effect on the public official's financial interests. Lastly, even if a public official has a disqualifying conflict of interest, a public official should consider whether either of the exceptions would allow him or her to participate.⁹

The first exception applies if the effect on the public official is indistinguishable from that on the public generally, discussed above. The second exception applies when a public official with a disqualifying financial interest is legally required to participate so that a decision may be reached, avoiding "government by paralysis." Cal. Gov't Code § 87101; *Kunec v. Brea Redevelopment Agency*, 55 Cal. App. 4th 511, 521 (1997).¹⁰

⁸ Violations of the PRA regarding a failure to recuse may be pursued criminally or civilly. Any person who knowingly or willfully violates any provision of the PRA, including a duty to recuse, is guilty of a misdemeanor. Cal. Gov't Code § 91000. In addition, no person convicted of a misdemeanor under the PRA shall be a candidate for any elective office or act as a lobbyist for four years following the conviction. Cal. Gov't Code § 91002. Civil actions brought by the FPPC, district attorney, or an elected city attorney include penalties up to \$5,000 per violation. Cal. Gov't Code § 91005.5. In addition, the court may temporarily restrain the execution of any action involving an alleged violation of the duty to disqualify, pending final adjudication of the allegation. Cal. Gov't Code § 91003(b). Upon final adjudication, if it is determined that a violation has occurred and the action might otherwise not have been taken without the violation, the court may set the official action aside as void. *Id.* The City's Ethics Ordinance applies to public officials, and requires that public officials avoid participation in a governmental decision in which they have a disqualifying financial interest. SDMC § 27.3561. Violations of the Ethics Ordinance may be pursued administratively or criminally. SDMC § 27.3583.

⁹ The FPPC regulations also allow a governmental decision to be segmented to allow participation by a disqualified public official if: (1) the decision can be separated into separate decisions that are not "inextricably interrelated" with the decision for which the public official has a disqualifying financial interest; (2) the decision for which the public official has a disqualifying interest is segmented from the other decisions; (3) the decision for which the public official has a financial interest is considered first and a final decision is reached by the agency without the disqualified public official's further participation; and (4) once the decision for which the public official has a financial interest is made, his or her participation does not result in a re-opening or otherwise financially effect the decision from which the public official was disqualified. Cal. Code Regs., title 2 § 18706(a).

¹⁰ In the event the decision is one before a body, this exception does not apply simply to break a tie vote of the non-recused public officials or to allow a disqualified public official to vote if a quorum of non-disqualified public officials can be convened, whether or not those other public officials are present at the time of disqualification. Cal. Code Regs., title 2 § 18705(c). In addition, the regulation requires that only the fewest officials with any legal conflict of interest participate. *Id.* Random selection of those individuals should be used and all disqualified members must participate in the selection. *Id.*; Letter from Lawrence T. Woodluck, Senior Counsel, Fair Political Practices Commission, to Craig A. Steele, Richards, Watson, Gershon PC (June 13, 2005) (on file with FPPC).

Questions regarding one's specific facts and circumstances as to any potential, prospective conflict of interest should be asked of the FPPC or of the Ethics Commission well in advance of any proposed participation that may be within these FPPC regulations.

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By /s/ Shannon M. Thomas

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