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January 14, 2015

Chair Remke and Members of the Commission
Fair Political Practices Commission
428 J Street, Suite 800
Sacramento, CA 95814

RE: Agenda Item 6: Regulation 18705 et seq.; Materiality Regulations

Dear Chair Remke and Commissioners:

On behalf of the League of California Cities City Attorneys FPPC Committee, I submit this letter for comment on the above-referenced agenda item.

INTRODUCTION

The Political Reform Act's conflict of interest provisions prohibit public officials from being involved in the making of a governmental decision when it is reasonably foreseeable that the decision will have a *material* financial effect on the official, or on one of the official's interests identified in Government Code section 87103. Thus, there is nothing in the Act as approved by the voters that requires a public official to disqualify themselves from decisions that would have *any* impact on their interests. Instead, the Act only requires disqualification when the foreseeable effects are "material." The Act tasks the Commission with identifying those financial effects that will be considered material.

The proposed regulations are intended to provide guidance on what level of financial effect the Commission has determined is material with respect to three classes of interest. Specifically, the purpose of the proposed regulations are to provide guidance to public officials (and their legal advisors) on the degree of financial effect the FPPC considers material for the purposes of analyzing conflict of interest questions involving (1) sources of income to the official, (2) sources of gifts to the official, or (3) the official's personal finances.

There is much that staff proposes that our committee supports. However, there are proposed provisions that we believe can be improved. Where alternative language is suggested, it is offered in the spirit of improving the expression of the concept stated in the proposed regulations as we understand it. It is not the intention to recommend a different policy.

The comments that follow are not presented in the order in which the regulations are presented in your packet and staff report. This letter first addresses Regulation 18705.5, because the other regulations incorporate that regulation by reference, and it is in that regulation where the fundamental change in approach in defining "material" is described. Comments on the proposed amendments to regulations 18705.3, 18705.4, and 18705, will follow in that order.

Regulation 18705.5: WHAT EFFECTS ON THE PERSONAL FINANCES OF A PUBLIC OFFICIAL ARE "MATERIAL"?

Regulation 18705.5 currently provides that the effect of a decision on an official's personal finances is material, "if it is at least $250 in any 12 month period." Consistent with the approach for real property and business entity interests, staff is recommending that this standard be replaced by a qualitative description. Staff's proposal involves the application of two standards, the standard stated in Regulation 18705.5 and the exception stated in Regulation 18705(b). Thus, an effect will be considered material if the decision will result in a "measureable financial benefit or loss" to the official, unless the effect is "nominal, inconsequential, insignificant, or immeasurable." Stated more simply, all effects on personal finances would be considered material, unless they are nominal, inconsequential, insignificant, or immeasurable."

Consistent with our comments on the real property and business entity standards, our committee prefers the straightforward "$250 in a 12 month period" standard. As advisors to government officials we feel much more comfortable applying that standard than determining whether an effect will be considered "nominal, inconsequential, insignificant, or immeasurable." For this reason we would recommend that the existing $250 standard be retained (or reduced to some other dollar value if there is a sense that it is too high).

Having said this, I recognize that the Commission has consistently adopted staff's recommendation to move away from a quantitative approach, and is likely to adopt a more qualitative approach to personal finance conflicts. With this in mind, our committee has identified a number of concerns with the language staff proposes, and I have prepared and offer for your consideration alternative language to address those concerns. (The alternative language proposed was developed after our committee's conference call, and I did not have time to convene another call. As such, this alternative language represents my own efforts, and has not been formally endorsed by the committee.)

As stated above, proposed Regulations 18705.5 and 18705 provide that "measureable" effects are considered materials, so long as they are not "nominal, insignificant, inconsequential, *or* immeasurable." The use of the disjunctive means that measureable effects will not be material if they are nominal, or inconsequential, or insignificant, or immeasurable. Putting aside the lack of guidance on what the FPPC will consider to be nominal, or inconsequential, or insignificant, or immeasurable, we find that most of these terms are problematic and should not be used.

For example, saying an effect is material if it is measureable, unless it is immeasurable is simply repetitive and unnecessary. Saying an effect is material if it is measureable, unless it is insignificant results in a different problem. The term "insignificant" has the same meaning as "not significant." Using this equivalent, the proposed regulation can be interpreted as stating that measureable effects are material, unless they are not significant, or, only significant effects are "material." This interpretation (an effect must be significant to be material) seems to set the bar too high.

This leaves material effects as meaning effects that are not "nominal or inconsequential." These terms are certainly qualitative, but on their own, provide no guidance to officials and their advisors on what magnitude of effect we are talking about.

Moreover, this language is problematic in that it does not answer another key question in conducting the analysis: Is "materiality" relative to the financial condition of the official? In other words, when giving advice on whether an effect will be considered nominal or inconsequential should we consider whether the official has the assets of Warren Buffett, as opposed to a senior citizen surviving on their social security check? The proposed regulation offers no insight into the FPPC's position on this question, and we think it should.

AN ALTERNATIVE:

The attached exhibit A contains proposed language that would present a "qualitative" statement on materiality that seeks to address the concerns identified above. The policy objective underlying the disqualification requirement is to prohibit officials from being involved in the making of government decisions when they might be tempted to put their private financial interests before the public interest. The alternative language seeks to provide better guidance by incorporating this policy into the language of the regulation. In addition, the proposal makes clear that the official's financial condition is not relevant to the analysis. The use of the term "any official" is intended to serve this purpose.

Regulation 18705.3: WHAT EFFECTS ON AN OFFICIAL'S SOURCE OF INCOME ARE "MATERIAL"?

Staff proposes to make three changes to the existing regulation: (1) the adoption of a different standard for sources of income from the regular conduct of business from that applied to the casual sale of property, (2) the elimination of the numerical standards for nonprofits, government agencies, and individuals, and (3) the addition of the retail sales exception to this regulation.

The Changes to the Numeric Standards

Subsection (a)(1) and (2)
This section when read in concert with Regulation 18705(b) provides that the effects of a decision on an individual source of income to the official will be material if the source is

directly involved in the decision, unless the effects will be nominal, inconsequential, insignificant, or immeasurable. We think this language is unnecessary if the proposed alternative for 18705.5 is adopted. If this is done, subdivision (2) would become subdivision (1) and would apply to individual sources of income.

Subsection (3)
I would propose the replacement of the numeric standard for nonprofits with a standard similar to that drafted for personal finances. This is also included on the attached exhibit A.

<u>Elimination of standard for Governmental Agencies</u>
Our committee supports staff's recommendation to eliminate the standards for financial effects on governmental agencies.

Subdivision (b) Income from Sale of Personal or Real Property
Our committee supports staff's proposal to treat sources of income from the casual sale of property differently than sources of more regular income, and supports adoption of subdivision (b).

Subdivision (d) Income from Retail Sales of a Business Entity
Our committee supports staff recommendation on adding this exception to this regulation, and, in general, supports staff's proposed text. We did have some concern about potentially different interpretations of the term "any specialized interest" on page 5, line 27, and suggest that the addition of some illustrative examples might help clarify what is meant.

Regulation 18705.4 WHAT EFFECTS ON A SOURCE OF GIFTS TO THE OFFICIAL ARE "MATERIAL"?

Staff proposes standards that are dependent upon whether the donor is an individual, a nonprofit, or a business entity. I would support this approach with the modified standards described in exhibit A for individual and nonprofit donors. In addition, for the reasons described above, we would recommend the deletion of subdivision (a).

Regulation 18705 MATERIALITY STANDARDS

Staff proposes several nonsubstantive edits to the provisions of subdivision (a). Our committee supports those edits.

Staff proposes the deletion of subdivision (b). Our committee supports that amendment.

In new subdivision (b), staff proposes an overarching exception to the materiality standards found in the regulation 18705.1 through 18705.5. For the reasons explained above, with the adoption of the proposed alternative language found in exhibit A, this subdivision would no longer be necessary, and can be omitted.

Before closing, I would like to thank Commission staff (Mr. Lenkeit, in particular) for the opportunity to provide input during the development of the proposed regulations. It is a challenging task to define the concept of "material" without reference to a somewhat arbitrary dollar amount, and Mr. Lenkeit has been open to discussing his efforts, and to allowing our committee to provide input to his work. We appreciate being given the opportunity to participate in this manner.

Thank you for your consideration of these comments.

Sincerely,

Shawn M. Mason (vb)

Shawn M. Mason
City Attorney of San Mateo
Chair, League of Cities FPPC Committee

Exhibit A

To replace second sentence of subdivision (a) of proposed 18705.5:

A reasonably foreseeable financial effect is material if a reasonable person would find that the effect is large enough to be measured and significant enough that it could tempt any public official to put their private financial interests before the public interest in making the decision.

To replace subdivision (a)(3) of 18705.3:

The source is a nonprofit and a reasonable person would find that the effect on the nonprofit is large enough to be measured and significant enough that it could tempt any public official to put the financial interests of the nonprofit before the public interest in making the decision, or the official knows or has reason to know that the nonprofit has an interest in real property that will be financially affected under the standards applied to a financial interest in Regulation 18705.2; or

To replace subdivision (c) of 18705.4:

The source is a nonprofit and a reasonable person would find that the effect on the nonprofit is large enough to be measured and significant enough that it could tempt any public official to put the financial interests of the nonprofit before the public interest in making the decision, or the official knows or has reason to know that the nonprofit has an interest in real property that will be financially affected under the standards applied to a financial interest in Regulation 18705.2; or