

# Memorandum

To : Members of the Commission

Date : May 24, 1979

From : **FAIR POLITICAL PRACTICES COMMISSION**  
Ted Prim

Subject: 18702 - Material Financial Effect

In addition to a revised copy of Regulation 18702, we have provided you with this memorandum and two charts outlining the application of the regulation to various types of financial interests. Before I explain the important differences between this draft and its predecessor, several introductory points should be made.

First, we have used strikeouts and underlinings in the regulation to illustrate the differences between these two drafts. I think the way in which we have done this is the best way for the Commission to compare them. However, because the format of the two drafts is different, the strikeouts and underlinings are intended to highlight substantive changes in the regulation rather than to indicate every single word change. In case you have any questions, we have included a copy of the previous draft in your Commission package.

Second, we have included two charts illustrating the application of the regulation to specific situations. One chart covers business entities and the other covers interests in real property.

## ANALYSIS

In subsection (a) of the regulation, we have changed the general test to be whether the decision in question will have a "significant" effect on the financial interest rather than a "substantial rather than insignificant" effect. At the last meeting, the Commission indicated that it wished to strike the words "rather than insignificant" from the regulation thereby hinging materiality on whether the decision would have a "substantial" effect. If the Commission still wishes to strike the words "rather than insignificant"

from the test, the staff would prefer that the word "substantial" be replaced with "significant". We think that the word "significant" standing alone establishes a standard which has a greater qualitative element than does the word "substantial", which is primarily quantitative in nature. Therefore, the "significant" standard provides the Commission with greater leeway to take account of surrounding circumstances in determining whether a decision will have a material financial effect.

In the introductory part of subsection (b), the regulation has been modified to provide that "consideration should be given to the numerical and percentage thresholds set forth in following sections. This is the language requested by the Commission and it should provide ample flexibility.

The thresholds have been revised to provide a floor below which an effect will not be material even if the percentage test is satisfied. For example, if the net income of a business entity will not be affected by at least one thousand dollars, the decision will not foreseeably have a material financial effect under the regulation even if the decision foreseeably will affect net income by one half of one percent or more.

A sentence has been added at the end of subsection (b)(1)(C) to make it clear that expenses which are incurred by virtue of a governmental decision decrease the assets of a business within the meaning of the regulation even if the non-cash assets are increased by virtue of the expense. For example, if a government decision requires the installation of new equipment, the business will be required to spend money for the purchase and installation of the equipment. The requirement that such an expenditure be made negatively affects the business' cash assets and liabilities. Theoretically, this negative affect is neutralized by the fact that the business has acquired additional non-cash assets in the form of the equipment. However, in a real sense, the business has been negatively affected by the decision since it has been required to spend money on something it did not want and that money cannot be spent for other purposes.

This interpretation of "materiality" is consistent with the fact that all of the businessmen interviewed indicated that they viewed with great concern all governmental decisions which affected their businesses and that their concern was heightened when the governmental decision in question required the expenditure of money.

Below is a summary of the thresholds set forth in the current regulation and in the proposed draft.