California Fair Political Practices Commission
MEMORANDUM

To: Chairman and Commissioners

From: Luisa Menchaca, Assistant General Counsel
John Vergelli, Staff Counsel, Legal Division

Re: Pre-notice discussion of possible amendments to Regulation 18704.2 and Regulations 18705.2 (Conflicts project phase 2, project 'D').

Date: January 24, 2000

I. Introduction

This project looks at the Commission's rules for deciding whether the reasonably foreseeable financial effects of a governmental decision on real property in which a public official has an economic interest are *material*. (Regulation 18705.2.) The Commission's rules for deciding whether real property in which a public official has an economic interest is directly or indirectly involved in the governmental decision (Regulation 18704.2) are also discussed because some of the possible "fixes" to the materiality standards involve the interrelationship of the materiality standards to the rules about degree of involvement.

The remainder of this introduction explains the current state of the law, and how it came to be the way it is. Part II of the memo examines a proposal submitted by Rene Auguste Chouteau, the Santa Rosa City Attorney. (His letter to the Commission is included in Appendix A.) Part III examines other ideas for improving this regulation. Part IV has recommendations.

Legal background, and where this work fits in the "eight-step process."

Under the Political Reform Act ("Act"), a public official has a conflict of interest in a governmental decision if it is reasonably foreseeable that the decision will have a *material* financial effect on one (or more) of his or her economic interests (unless the public generally exception applies). (Section 87103.) The current materiality rules are in the 18705 series of regulations.[1]

"Material" means "important." (Black's Law Dict., 5th ed. 1979, p. 880, col. 2.) Regulation 18705.2 sets out the *materiality standards* for *real property* in which a public official has an economic interest. These materiality standards are the answers to the question, "how much of a financial effect on a given parcel of real property is important enough to trigger a conflict?" Pursuant to Section 87103, the regulation measures the materiality of the financial effect *on the real property*, not on the public official himself or herself, or on the value of the public official's investment in the real property.

The materiality standards are step five in the standard analysis adopted by the Commission in phase 1 of the Conflicts Project. (See Regulations 18700(b), 18700(b)(5).) A person *applying* these materiality standards will have already done the following analysis:

Step One: Decided that the individual who might have a conflict is a *public official* and, thus, subject to the conflicts rules in the first place. (Regulations 18700(b)(1), 18701.)

Step Two: Decided that the public official who might have a conflict will be *making, participating in making, or influencing* a governmental decision and, thus, engaging in the kind of conduct regulated by the conflicts rules. (Regulations 18700(b)(2), 18702 et seq.)

Step Three: Decided that the public official who might have a conflict has an *economic interest in real property* and, thus, has one of the types of interests that can give rise to a conflict under the Act. (Regulations 18700(b)(3), 18703.2.)

Step Four: Decided whether the real property in which the public official has an economic interest is *directly or indirectly involved* in the governmental decision the public official would be making, participating in making, or influencing. (Regulations 18700(b)(4), 18704.2.)

Having thus arrived at step 5, there is currently one materiality standard that applies when real property is *directly involved* [(2)] in a governmental decision: In such a case, *any* reasonably foreseeable financial effect from the decision is deemed material. (Regulation 18705.2(a); this is sometimes called a "one-penny" rule, since even a penny's worth of reasonably foreseeable financial effect is material.)

When the real property is *indirectly involved*, subdivision (b) of the current regulation applies. The premise underlying subdivision (b) is straightforward: The farther the public official's real property is from the real property which is the subject of the governmental decision, the less likely that the financial effect of that decision on the public official's real property will be material. Unfortunately, the implementation of that straightforward premise has proven to be somewhat complex.

The drafters of current subdivision (b) created three zones around the real property which is the subject of the governmental decision, and also created a materiality standard for each zone. Which materiality standard applies to the real property in which a public official has an economic interest depends on which zone it falls into.

The inner zone might be called the "very close" zone. The drafters reasoned that if the real property in which the public official has an economic interest is "very close" to the real property which is the subject of the governmental decision, then one can *almost* presume that the governmental decision will have a *material* financial effect on the public official's real property. So, the drafters assigned a very stringent materiality standard to the "very close" zone: the effect of a decision is deemed material, "unless the decision will have no financial effect upon the official's real property." (Regulation 18705.2(b)(1)(A).) This is another version of the "one-penny rule." (See parts III.A and III.B, below.) The drafters chose 300 feet as the outer boundary of the "very close" zone, borrowing that figure from other state law.[(3)]

The outer zone might be called the "probably-far-enough-away" zone. The drafters reasoned that as the distance from the real property which is the subject of the decision to the public official's real property *increases*, at some point, the public official's real property is far enough way to presume that a *material* financial effect is not likely. The drafters picked one-half mile as a radius to describe the *inner* boundary of this "probably-far-enough-away" zone, and rounded this figure to 2,500 feet.

The drafters factored the "public generally exception" concept into their reasoning: As distance from the real property which is the subject of the decision to the public official's real property *increases*, there are likely to be more and more properties similarly financially affected by the decision.

Under Regulation 18705.2(b)(2), if the real property in which a public official has an economic interest is more than 2,500 feet from the real property which is the subject of the decision, the financial effect of the decision on the public official's real property is considered material only if two conditions are met:

(1) There are "specific circumstances" indicating a reasonably foreseeable material financial effect using the materiality standards from the "middle zone" rule (see below); *and*

(2) "The [financial] effect will not be substantially the same as the effect upon at least 25 percent of all the properties which are within a 2,500 foot radius of" the public official's real property *or* there are not at least 10 properties under separate ownership within a 2,500 foot radius of the public official's real property.

Between the "very close" zone and the "probably-far-enough-away" zone, Regulation 18705.2(b) creates a "middle zone" (300 feet to 2,500 feet, Regulation 18705.2(b)(1)(C)). In this "middle zone," the drafters reasoned that no presumptions were supportable because of the wide variety of possible governmental decisions, of real property interests, and of interrelationships of the decisions and properties. In the scheme of subdivision (b), the public officials must "confront the analysis" if their real property is located in the "middle zone."[4]

The analysis which must be confronted is this: the public official must decide if it is reasonably foreseeable that the governmental decision will increase or decrease the fair market value of the real property in which he or she has an economic interest by $10,000 or more, *or* increase or decrease its rental value of the real property by $1,000 or more per 12-month period. (Regulation 18705.2(b)(1)(C).)

It is this "middle-zone" analysis which has created the most problems and controversy over the years--indeed, City Attorney Chouteau (and others) would have you simply abandon it. (See part II, below.)

Regulation 18705.2(b) creates one other materiality standard, one which does not depend on the distance from the public official's real property to the real property which is the subject of the decision. If the "decision involves construction of, or improvements to, streets, water, sewers, storm drainage, or similar facilities, and the real property in which the official will receive new of substantially improved services," then the financial effects of the decision are deemed material. (Regulation 18705.2(b)(1)(B).)

II. City Attorney Chouteau's proposal

City Attorney Chouteau begins by noting that the "circumstance most often encountered by my office is a request by a Council member for advice regarding a project which would be constructed within 2,500 feet of the Council member's personal residence." He explains that hiring an appraiser to conduct the middle zone analysis (see part I, above) is expensive, protracted, and ultimately unreliable.

In his own words, City Attorney Chouteau thus proposes,

"... elimination of the subsection (b)(1)(C) [of Regulation 18705.2], which requires the public official to initial an appraisal process if the project lies between 300 feet and 2,500 feet from his or her property."

He goes on to contend,

"I submit that as a matter of practical application, if projects are within 300 feet of a person's property, there is at least an argument that a particular project will affect the value of the real property in some way. As to projects lying further than 300 feet from a particular piece of property, any effect on the property is highly speculative, and to the average citizen, even the appearance of conflict is not readily apparent."

Although it is not entirely clear from City Attorney Chouteau's original submission, subsequent discussions with other representatives of the regulated community indicate that the proposal contemplates that the current "probably-far-enough-away rule" (Regulation 18705.2(b)(2)) would apply at 300 feet and further.

Several aspects of City Attorney Chouteau's proposal deserve attention. First, his assertion that the "middle zone" analysis (the 300 feet to 2,500 feet rule of Regulation 18705.2(b)(1)(C)) is the most pressing issue in this area seems to be correct. Perhaps the most often-disqualifying economic interests for public officials are their personal residences, an economic interest in real property under the Act. Of course, this observation is not necessarily an indication that there is a "problem" with the law, because personal residences are probably the most widely held economic interest of public officials. However, it clearly points out the need to do the best we can with this regulation.

Second, City Attorney Chouteau asserts, without qualification, that the regulations "require" an appraisal when the public official's real property is in the middle zone. This is not, as a matter of law, correct. The regulation does not, and has never, *required* an appraisal.

What *is* true is that many, if not most, public officials and their counsel, feel that they have no choice but to have an appraisal if they are in the "middle zone." At the risk of oversimplifying a long, complex evolution, the following seems to have happened. At some point, a public official faced with the "middle zone" analysis sought advice from the Commission, asking if it would help to have an appraisal. The Commission staff advised that it would. Other public officials read this advice, and similarly sought appraisals. At some point, the Commission staff advised that an appraisal cited in an advice request wasn't adequate because it failed to consider a certain factor. Similar advice followed about other factors in appraisals. The accumulation of this advice about appraisals, combined with the unquestionable difficulty of predicting financial effects in the real world and the inevitable political consequences of allegations of conflicts from opponents, has led cautious public officials to perceive that appraisals are a *de facto* requirement if their real property economic interest falls in the middle zone.

Clearly, this result was *not* what the Commission intended when it passed Regulation 18705.2(b)(1)(C). The intent was to establish a financial benchmark, to which the public official could look while asking, "is it reasonably foreseeable that the financial effect of this governmental decision will be above or below the benchmark?" It was never intended that the public official be required to reduce the substantially likely financial effect of a governmental decision to a dollar certain, or even to estimate it's ultimate effect in dollars--only to estimate whether the ultimate effect was substantially likely to be over or under the $10,000 line.

Third, City Attorney Chouteau contends that the financial effects of a governmental decision on real property more than 300 feet from the property which is the subject of the decision are "highly speculative," and do not create even the appearance of a conflict of interest to the average citizen.

Reasonable minds can disagree easily with this assertion. Three hundred feet to 2,500 feet is not that great a distance, easily within line-of-sight for most properties. Real property economic interests tend to be relatively valuable (e.g., a typical public official's home is his or her most significant asset), so people tend to care greatly about what happens nearby. One may easily list a number of typical land uses which if approved within 2,500 feet of real property may have a profound impact on the real property's values: roads, half-way houses, adult-oriented businesses near other businesses, high-density housing near single-family residences, industrial or commercial uses near residential uses, etc. It is fair to say that many will disagree with the assertion that the financial effects of governmental decisions on properties 300 feet to 2,500 feet away are "highly speculative" as a rule.

III. Other ideas for improving Regulation 18705.2

A. Clarifying the multiple, arguably inconsistent, expressions of the "one-penny rule" in the regulation.

As explained above, the "any financial effect" standard in Regulation 18705.2(a), which applies to real property economic interests which are directly involved in a governmental decision, is referred to as the "one-penny