New Rules for Conflicts of Interests Involving Sources of Income and Business Entities

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ATTORNEYS

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Under the Political Reform Act, public officials may not make, participate in making, or attempt to use their official positions to influence a governmental decision in which they know or have reason to know that they have a disqualifying interest. A public official has a disqualifying interest if the governmental decision at issue will have a reasonably foreseeable, material effect on the official's financial interests. Earlier this year, the Fair Political Practices Commission (FPPC) amended the standard for determining whether a decision will have a material effect on a public official's interest in real property. The FPPC now has amended the materiality standards for both sources of income and business entities.

With respect to financial interests in ***sources of income***, the FPPC now includes bright-line standards for determining material financial effect. If the official's source of income is a "named party in, or the subject of the decision," the effect will be considered material and the official will have a conflict of interest. If an official's source of income is an ***individual,*** materiality no longer depends on the potentially ambiguous "measurable financial benefit or loss" standard. Instead, the decision will have a material effect if the decision may affect the individual's income, investments, or other assets or liabilities ***"by $1,000 or more,"*** or if the decision will have a material effect on the individual's real property or business interests.

With respect to financial interests in ***business entities***, a decision explicitly involving a business entity in which a public official has a financial interest will be considered material. If the business entity is not explicitly involved in the decision, however, materiality depends on the decision's potential effect on the entity's gross revenues, assets, liabilities, and expenses. Revised Regulation 18702.1 includes numeric thresholds to determine materiality in those situations.

Importantly, the FPPC has created a new ***"small shareholder"*** exception that allows officials to participate in decisions explicitly involving a business entity where the official's only interest in that business entity is an investment interest worth no more than $25,000. To qualify for this exception, the interest also must be less than one percent of the business entity's shares. However, meeting these thresholds does not automatically allow the official to participate in the decision. The official still must analyze the decision's potential effect on the business entity's annual gross revenues, assets and liabilities, expenses, and real property interests. Under this rule, even where an official has only a small investment in a business entity, the impact of a decision might be so significant that the official still has a conflict of interest.

The FPPC also expanded the "nexus" test to address income received by an official's spouse. Now, when an official receives or is promised income - either due to the official's own employment ***or the spouse's employment*** - and the receipt of that income is received or promised for the purpose of achieving a specific goal, the official will have a disqualifying financial interest in any decision that would achieve, defeat, aid, or hinder that specific goal. Finally, the FPPC regulation clarifies the standards for sources of income that are nonprofit organizations and governmental entities.

The Revised FPPC Regulations can be viewed **here**.

If you have any questions about conflicts of interest under California law, or how these amendments may impact your jurisdiction, please contact **Diana Varat**.