



## FACT SHEET ON DISQUALIFICATION FROM MUNICIPAL DECISIONS PART 1: INTERESTS IN BUSINESS ENTITIES

The City's ethics ordinance includes laws that prohibit city officials from influencing municipal decisions when it is reasonably foreseeable that those decisions will have a material financial effect on their economic interests. This fact sheet is one of a series of fact sheets designed to offer general conflict of interest guidance to city officials who participate in making municipal decisions. This particular fact sheet is focused on conflicts that result from investments in business entities or from serving in a position of management in a business entity. Keep in mind that the information offered in this fact sheet should not be considered a substitute for the actual language contained in local and state law.

### GENERAL RULES

- ❖ The ethics ordinance prohibits city officials from participating in a municipal decision if it is reasonably foreseeable that the decision will have a material financial effect on any business entity in which the official, or a member of the official's immediate family, has an investment worth \$2,000 or more. Such interests include things like ownership of a family business or stock in a publicly traded company.
- ❖ The ethics ordinance also prohibits city officials from participating in a municipal decision if it is reasonably foreseeable that the decision will have a material financial effect on any business entity in which the official serves as a director, officer, partner, trustee, employee, or otherwise holds any position of management (even if the individual is not compensated for such services).
- ❖ The term business entity means any organization or enterprise operated for profit. It does not, on the other hand, include a bona fide non-profit organization or governmental agency.
- ❖ The term immediate family means an official's spouse (which includes a registered domestic partner) and any dependent children. Under these rules, for example, a city official whose spouse owns a billboard company may be unable to participate in a City decision to change zoning for outside advertising.
- ❖ You must consider your spouse's investments in business entities for disqualification purposes even if you have an agreement (such as a pre-nuptial agreement) stating that you have no legal interest in the other person's investments.
- ❖ If you have an investment in a business entity, you must also consider any parent, subsidiary, or affiliate of the business entity for disqualification purposes. Please contact the ethics commission for additional information regarding the criteria for a parent, subsidiary, or affiliate relationship.
- ❖ Whether the financial effect of a municipal decision on a business entity is material depends on the applicable facts. As a general rule, however, the financial effect will be material if the business entity is the subject of the decision or if the decision will have a significant financial impact on the business entity, as discussed more fully below.

## **MATERIALITY – BUSINESSES THAT ARE THE SUBJECT OF THE DECISION**

- ❖ The financial effect of a municipal decision on a business entity in which an official has a financial interest is “material” whenever the business entity:
  - ✓ initiates the proceeding in which the municipal decision will be made by filing an application, claim, appeal, or request for other government action concerning the business entity;
  - ✓ offers to sell a service or product to the City;
  - ✓ bids on or enters into a written contract with the City, or is identified as a subcontractor on a bid or contract with the City;
  - ✓ is the named manufacturer or vendor of any products purchased by the City with an aggregate cost of \$1,000 or more in any 12-month period;
  - ✓ applies for a permit, license, grant, tax credit, exception, variance, or other entitlement from the City;
  - ✓ is the subject of any inspection, action, or proceeding under the City’s regulatory authority; or
  - ✓ is otherwise subject to an action taken by the City that is directed at the business entity.
- ❖ In other words, when a business entity is explicitly involved in a particular municipal decision, the impact is considered material, and disqualification is generally required.
- ❖ For example, Susan is a deputy director in the purchasing department. Her spouse owns a company that sells electronic parking meters and is responding to a City RFP. Because her spouse’s company is offering to sell a product to the City, the City’s purchasing decision will have a material financial effect on that company. Accordingly, Susan is disqualified from participating in the decision.
- ❖ Another example: Stanley is a member of the planning commission. He is also a co-owner of a construction business that has applied for a site development permit. If the permit comes before the planning commission, Stanley must recuse himself because approving or denying the permit will have a material financial effect on a business entity in which he has a financial interest.
- ❖ Different rules apply when a city official’s only interest in a business entity is an investment interest of \$25,000 or less, so long as the investment is less than 1% of the entity’s shares. In such circumstances, even when the business entity is the subject of the decision, apply the rules pertaining to entities that are merely affected by the decision.
  - ✓ For example, Hannah is a program manager with the parks and recreation department. She has been asked to participate in a decision concerning Pepsi’s desire for an exclusive deal with the City to put its products in vending machines in the City’s parks. Hannah owns \$10,000 worth of Pepsi stock. Even though Pepsi is the “subject of the decision,” Hannah’s investment in Pepsi does not automatically preclude her from participating in the decision. Instead, she must follow the rules below to determine whether the decision’s financial impact on Pepsi are significant enough to trigger her disqualification.
  - ✓ Under the \$25,000 investment rule, note that a business entity’s ownership of real property will not trigger disqualification solely on the basis of the property being the subject of a City decision. An official who owns stock in such an entity will be disqualified from a City decision

only when decision will substantially affect the company's revenues, assets, liabilities, or expenses; see below for further guidance.

## **MATERIALITY – BUSINESSES THAT ARE AFFECTED BY THE DECISION**

- ❖ Even if a city official has an interest in a business entity that is not the applicant, bidder, contracting party, or otherwise the subject of a municipal decision, the official could still be disqualified from participating in decisions that will financially affect the entity.
- ❖ In these circumstances, different kinds of materiality rules apply. Whether a financial impact is material largely depends on the size of the entity. For instance, a decision that causes a \$50,000 increase in revenue might be material to a small company, but comparatively negligible to a large corporation.
- ❖ When making a materiality determination for businesses affected by a municipal decision, examine whether the decision will impact the business entity's annual gross revenues, assets, liabilities, expenses, or real property interests. Such impacts are discussed below.

### **Annual Gross Revenues**

- ❖ The financial effect of a municipal decision on a business entity in which an official has a financial interest is material if there is a realistic possibility that the decision will increase or decrease the entity's annual gross revenues by at least:
  - ✓ \$1 million; or
  - ✓ 5%, so long as the increase or decrease is at least \$10,000.
- ❖ For example, Alexander is a policy advisor in the Mayor's office who owns several rental properties in Mission Beach. The Mayor is deciding whether to recommend a prohibition on short-term rentals in the beach areas. Because there is a realistic possibility that the decision will cause Alexander's rental income to decrease by 5% and by more than \$10,000, he may not participate in the decision.

### **Assets and Liabilities**

- ❖ The financial effect of a municipal decision on a business entity in which an official has a financial interest is material if there is a realistic possibility that the decision will increase or decrease the value of the entity's assets or liabilities by at least:
  - ✓ \$1 million; or
  - ✓ 5%, so long as the increase or decrease is at least \$10,000.
- ❖ Kim is a staffer in a City Council office. Her spouse is a part-owner of a family business that operates a fleet of City-permitted taxicabs. The City Council is deciding whether to remove the cap on taxicab permits. Because this decision will decrease the value of the permits held by her company by more than 5% and more than \$10,000, Kim may not lawfully participate in the decision.

## **Expenses**

- ❖ The financial effect of a municipal decision on a business entity in which an official has a financial interest is material if there is a realistic possibility that the decision will cause the entity to incur or avoid additional expenses, or to reduce or eliminate expenses by at least:
  - ✓ \$250,000; or
  - ✓ 1% of the entity's annual gross revenues, so long as the change in expenses is at least \$2,500.
- ❖ For example, Clyde is a member of the planning commission. He also owns a cannabis dispensary. The planning commission will be discussing a permitting requirement that cannabis dispensaries obtain pesticide-free certification from a state agency. Certification costs will be \$7,500. If \$7,500 represents 1% or more of the dispensary's annual gross expenses, Clyde may not lawfully participate in the decision.

## **Real Property Interests**

- ❖ The financial effect of a municipal decision on a business entity in which an official has a financial interest is material if the official knows that the entity has an interest in real property and either:
  - ✓ the property is the subject of the municipal decision (e.g., the decision changes the property's development criteria, zoning, assessments, etc.; see disqualification fact sheet concerning real property for additional guidance); or,
  - ✓ there is clear and convincing evidence that the decision would have a substantial effect on the property.
- ❖ For example, Delores is a council representative; her spouse is a partner in a company that owns a restaurant in a North Park neighborhood that the City plans to rezone. Because Delores has an economic interest in a business entity that owns or leases a parcel that is the subject of a municipal decision, Delores may not participate in the rezoning decision.

## **INSIGNIFICANT EFFECTS**

- ❖ Notwithstanding the rules set forth above, there are circumstances in which a municipal decision's financial effect is so minor that it does not rise to the level of being "material." In other words, a city official does not have a disqualifying conflict of interest in a municipal decision if the financial effect of the decision is nominal or inconsequential.
- ❖ For example, Mary is a deputy director in neighborhood code compliance who owns stock in Acme, Inc. worth \$4,500. Her department is considering Acme's request for a one-week extension to remove graffiti from one of their buildings. Because the decision to grant or deny the request is inconsequential in terms of any financial impact on Acme, Mary is not disqualified from participating in the decision.

## PUBLIC GENERALLY

- ❖ Even if the financial effect of a municipal decision on a city official's business interest is material, the official will not be disqualified from participating in the decision if he or she can establish that the financial effect on the business entity is indistinguishable from the financial effect on the public generally.
- ❖ A decision affecting a business entity is entitled to the public generally exception if the financial impact on the business entity is essentially the same as it is on at least 25% of all business entities located in the City.
- ❖ When determining whether a municipal decision's financial impact on a business interest is disproportionate to its impact on the City's other business entities, consider these types of factors:
  - ✓ the business entity's income producing potential;
  - ✓ the proximity of the business entity to the project that is the subject of the municipal decision;
  - ✓ when the official has interests in multiple similar business entities, whether the municipal decision's cumulative effect on those interests is greater than its effect on a single business entity; and,
  - ✓ when the decision imposes the same rate or percentage on all businesses, whether the official's interest is in an entity with a higher volume of business than other entities.
- ❖ In addition, the public generally exception will likely apply in the following special circumstances: (1) the imposition of taxes or assessments for water, utility, or other broadly provided public services applied equally or proportionally to everyone; (2) changes to parking rates, permits, and fees that apply to the entire City; (3) ordinances that restrict on-street parking, impose traffic controls, deter vagrancy, reduce nuisance, or improve public safety; (4) decisions that affect all renters of residential property; (5) situations in which the law requires a board or commission to contain appointees representing a particular trade or profession and there is no unique effect on the appointee; (6) states of emergency; and (7) permits, licenses or other use entitlements sought from an airport or harbor. Contact the ethics commission for assistance with these circumstances.

## CONTRACTS

- ❖ If the municipal decision involves a contract, be sure to also review the ethics commission's fact sheet on financial interests in a contract.

Determining whether or not you have a conflict of interest in a particular municipal decision can be a complicated matter. Do not hesitate to contact the ethics commission at (619) 533-3476 for additional assistance.

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