

[NOTE: In 2014, the California Fair Political Practices Commission amended Regulation 18706 to state that an outcome is “reasonably foreseeable” if it is a “realistic possibility.” An outcome need not be “substantially likely” to be considered “reasonably foreseeable.”]

February 28, 2006

SDEC Informal Advice Letter No. IA06-02

Advice Provided To:
Council President Scott Peters
City Council District 1
202 “C” St., 10th Floor
San Diego, CA 92101

Re: Request for Advice Regarding Disqualification from Municipal Decisions that Involve Interests in Business Entities

Dear Council President Peters:

This advice letter has been prepared in response to your memorandum to the City of San Diego Ethics Commission dated February 15, 2006. You are seeking advice from the Ethics Commission interpreting the provisions of the City’s Ethics Ordinance, which is contained in the San Diego Municipal Code [SDMC]. Your letter seeks the Commission’s assistance with regard to whether you may participate in municipal decisions pertaining to the securitization of tobacco settlement revenue.

QUESTION

May you participate in municipal decisions pertaining to the securitization of tobacco settlement revenue if your spouse owns stock in Citigroup and Lehman Brothers Holdings, two business entities that may participate in the bond issuance relating to the securitization?

SHORT ANSWER

As a City Official, you are prohibited from influencing a municipal decision if it is reasonably foreseeable that the municipal decision will have a material financial effect on any business entity in which you or your immediate family has invested \$2,000 or more. In particular, the determination of whether or not you may participate in municipal decisions pertaining to the securitization of tobacco settlement revenue depends on whether Citigroup and Lehman Brothers Holdings are directly or indirectly involved in the decision. If the business entities are directly involved in the municipal decision (e.g., as a party to a City contract), then it is presumed that the decision will have a material financial effect on these entities, and accordingly your spouse’s

ownership of stock in these entities will require you to disqualify yourself from participating in that decision. On the other hand, if one or both of the business entities are only indirectly involved in the municipal decision, then your disqualification will depend on the amount of financial effect the decision will have on those entities.

In addition, your spouse's ownership of stock in Citigroup and Lehman Brothers Holdings creates a financial interest for you that may preclude the City Council from being able to contract with these entities. You should perform an analysis under Government Code section 1091.5(a)(1) to ensure that a prohibited interest in a contract does not exist.

BACKGROUND

According to information provided in your memorandum, your spouse's separate property trust owns shares of Citigroup and Lehman Brothers Holdings valued at \$129,000 and \$300,000, respectively. Both companies have been mentioned in docket materials as participants in a future bond issuance relating to the securitization of tobacco settlement revenue, a matter currently pending before the City Council. You have asked for advice pertaining to "future actions" of the City Council and whether you would have a disqualifying conflict of interest that would impact your participation in "future issues." Because you have not identified a single municipal decision or a single set of facts, but are instead seeking advice applicable to potentially several different City Council actions concerning the tobacco settlement revenues, our advice must necessarily be of an informal nature. Thus, this advice letter is intended to provide you with a general analysis that should assist you in determining whether you have a disqualifying conflict of interest in any of the upcoming tobacco settlement revenue decisions that involve Citigroup or Lehman Brothers Holdings.

DISQUALIFICATION ANALYSIS

The question you present requires us to look at the City's Ethics Ordinance, which is located at SDMC sections 27.3501 through 27.3595. The Ethics Ordinance contains the City's rules governing conflicts of interest. Applicable definitions and provisions from the Political Reform Act and the related regulations adopted by the California Fair Political Practices Commission [FPPC] expressly apply to the City's Ethics Ordinance. SDMC § 27.3503. We therefore turn to interpretations of state law from time to time for guidance in interpreting the City's Ethics Ordinance. These interpretations occur in the form of FPPC advice letters, some of which are cited in the analysis below.

A. General Prohibition

SDMC section 27.3561 prohibits a City Official from knowingly influencing a municipal decision if it is reasonably foreseeable that the municipal decision will have a material financial effect on "any business entity in which the City Official or a member of the City Official's immediate family has invested \$2,000 or more." In other words, given your spouse's ownership of stock as set forth above, you may not participate in any City decisions where it is reasonably foreseeable that the decision will have a material financial effect on Citigroup or Lehman

Brothers Holdings.¹ In order to determine whether your spouse's ownership of stock in these business entities triggers your disqualification, we must examine the meanings of the key terms contained in section 27.3561: "influencing a municipal decision," "reasonably foreseeable," and "material financial effect."

B. Influencing a Municipal Decision

The Ethics Ordinance defines the term "influencing a municipal decision" as follows:

Influencing a municipal decision means affecting or attempting to affect any action by a City Official on one or more municipal decisions by any method, including promoting, supporting, opposing, participating in, or seeking to modify or delay such action. Influencing a municipal decision also includes providing information, statistics, analysis or studies to a City Official.

SDMC § 27.3503.

As a member of the City Council, which has the responsibility of determining how the tobacco settlement revenues will be used, it is clear that any participation (e.g., voting, supporting, opposing, etc.) in that determination will result in you "influencing a municipal decision."

As Council President, with the responsibility of docketing items that come before the City Council, it appears that you are participating in a municipal decision when you decide to place, or not place, a particular item on the docket. Therefore, should you find yourself disqualified from participating in a municipal decision, it is our advice that you recuse yourself from any docketing decisions related to that matter. This advice is consistent with the advice we gave former Mayor Dick Murphy in our January 6, 2005, advice letter (SDEC Adv. Ltr. FA05-01), as well as the advice rendered by the FPPC in *In re Robb*, FPPC Adv. Ltr. A-01-135. In the *Robb* letter, the FPPC stated that placing a matter on an agenda "would clearly be an effort to 'influence' the decision of the board on that issue." Thus, to the extent that you find yourself disqualified from participating in a particular matter, you should defer all docketing decisions related to that matter to the President Pro Tem, who, under Rule 4.3 of the Permanent Rules of the Council (SDMC § 22.0101.5), is authorized to perform all the duties of the President when the President is unable to perform his or her duties.

C. Reasonably Foreseeable

The term "reasonably foreseeable," although not defined in the Ethics Ordinance, has been thoroughly analyzed by the FPPC in its advice letters. The FPPC has opined that an effect is considered "reasonably foreseeable" if there is a substantial likelihood that it will occur. *In re Orlik*, FPPC Inf. Adv. Ltr. I-98-175. The FPPC has also stated in several advice letters that in the

¹ For purposes of this analysis, it is irrelevant that your wife's ownership of stock is a separate property interest. A public official is considered to have a financial interest in any investments owned by his or her spouse, even when the investment is held as separate property. *In re Ryan*, FPPC Adv. Ltr. A-99-027; *In re Johns*, FPPC Adv. Ltr. A-92-657.

earlier stages of a project or process, there is less likely to be a substantial likelihood of a material financial effect than in the later stages of a project. *In re Biondo*, FPPC Adv. Ltr. I-90-071; *In re Ragghianti*, FPPC Adv. Ltr. I-98-064. Ultimately, in order for your spouse's stock ownership to trigger your disqualification, it must be "substantially likely" that the subject decision will have a material financial effect on Citigroup or Lehman Brothers Holdings.

D. Material Financial Effect

According to SDMC section 27.3561(c), "material financial effect" has the same meaning as that set forth in sections 18705 through 18705.5 of the California Code of Regulations. Regulation 18705.1 sets forth the materiality standards for "direct" and "indirect" economic interests in business entities such as Citigroup and Lehman Brothers Holdings. This regulation provides that the financial effect of a governmental decision on a business entity that is "directly involved" in the decision is presumed to be material. In other words, if Citigroup or Lehman Brothers Holdings are "directly involved" in the municipal decision, there is a presumption that the decision will have a material financial effect on those entities. On the other hand, if these business entities are merely "indirectly involved" in the decision, it is presumed that the decision's financial effect on the entities will be material only if certain dollar thresholds are met.

A determination must be made, therefore, with regard to whether Citigroup and Lehman Brothers Holdings are "directly involved" or "indirectly involved" in the upcoming municipal decisions regarding the securitization of tobacco settlement revenue. FPPC Regulation 18704.1 contains guidelines for determining whether a business entity is directly or indirectly involved in these kinds of decisions. According to this regulation, a business entity is considered to be "directly involved" in a governmental decision if it "(1) initiates the proceeding in which the decision will be made by filing an application, claim, appeal, or similar request or; (2) is a named party in, or is the subject of, the proceeding concerning the decision before the official or the official's agency. A person is the subject of a proceeding if a decision involves the issuance, renewal, approval, denial or revocation of any license, permit, or other entitlement to, or contract with, the subject person." FPPC Regulation 18704.1(a).

Because your request for advice does not identify a particular municipal decision concerning the disposition of tobacco settlement revenues, this letter cannot address with any specificity whether or not one or both of these business entities will be directly or indirectly involved in the future decisions involving those revenues. You must make that determination on a case by case basis. Nevertheless, we can offer some general guidance. According to the facts you have presented, it appears unlikely that either Citigroup or Lehman Brothers Holdings will be "initiating the proceeding" with regard to any of the matters coming before the City Council on the subject of securitizing the tobacco settlement revenue. It does appear, however, that these future decisions will "involve" a contract with the subject business entities. If that is the case, these entities will be, to some degree, the subjects of those particular decisions, and accordingly they will be considered "directly involved" in the municipal decisions.

As indicated above, whether Citigroup or Lehman Brothers Holdings are directly or indirectly involved in a particular municipal decision depends on the facts applicable to that decision.

Once you determine whether their involvement is “direct” or “indirect,” you can conclude the analysis, as follows:

Directly Involved

If, with regard to a particular municipal decision, you determine that Citigroup or Lehman Brothers Holdings are “directly involved” in that municipal decision, then the financial effect of the decision is presumed to be material. FPPC Regulation 18705.1(b).² If that is the case, your spouse’s ownership of stock in Citigroup or Lehman Brothers, or both, will generally create a situation in which you would be legally precluded from participating in that municipal decision. Note, however, that there may be circumstances in which a business entity, despite being “directly involved” in a municipal decision, will not be financially affected by that decision. FPPC Regulation 18705.1(b)(2) provides that the presumption of materiality for a “directly involved” business entity may be rebutted by proof that it is not reasonably foreseeable that the decision will have any financial effect on the business entity. Thus, if you can show that a particular municipal decision pertaining to the securitization of the tobacco settlement revenues is not substantially likely to have any financial effect on either Citigroup or Lehman Brothers Holdings, then your spouse’s interest in these entities will not create a disqualifying conflict of interest with regard to that decision. If you are unable to make such a showing, then the presumption will be upheld and you will have a disqualifying conflict of interest.

Indirectly Involved

If you determine that Citigroup or Lehman Brothers Holdings are only “indirectly involved” in a particular municipal decision, you would apply the materiality standard set forth in FPPC Regulation 18705.1(c). Because both business entities are listed on the Fortune 500, the applicable standard is found in subsection (c)(1), which provides that the financial effect of a governmental decision on a Fortune 500 business entity is material if it is reasonably foreseeable that:

- (A) The governmental decision will result in an increase or decrease in the business entity’s gross revenues for a fiscal year of \$10,000,000 or more; or
- (B) The governmental decision will result in the business entity incurring or avoiding additional expenses or reducing or eliminating existing expenses for a fiscal year in the amount of \$2,500,000 or more; or
- (C) The governmental decision will result in an increase or decrease in the value of the business entity’s assets or liabilities of \$10,000,000 or more.

² Under FPPC Regulation 18705.1(b)(2), an exception exists for investments worth \$25,000 or less. Because your spouse’s investments in Citigroup and Lehman Brothers are worth well in excess of \$25,000, the exception does not apply.

E. Application of Facts to the General Rule

As stated above, the Ethics Ordinance prohibits a City Official from influencing a municipal decision if it is reasonably foreseeable that the municipal decision will have a material financial effect on any business entity in which the City Official or a member of the City Official's immediate family has invested \$2,000 or more. Thus, to the extent that Citigroup or Lehman Brothers Holdings are "directly involved" in a particular municipal decision, and to the extent that the presumption of materiality cannot be overcome, your spouse's investments in those business entities create a conflict of interest that requires your disqualification from participating in that decision.

On the other hand, to the extent that Citigroup or Lehman Brothers Holdings are only "indirectly involved" in a particular municipal decision, your spouse's investments in those business entities create a conflict of interest that prevents your participation in that decision if any of the \$10 million / \$2.5 million / \$10 million thresholds identified in FPPC Regulation 18705.1(c)(1) are met. In other words, the key question for these business entities, if "indirectly involved," may be restated as follows: Is it substantially likely that passage of the subject resolution or ordinance will result in either Citigroup or Lehman Brothers earning (or losing) \$10 million in a single fiscal year?³ If you can conclude from the facts before you that it is not substantially likely that either of these entities will earn (or lose) \$10 million in a fiscal year because of the municipal decision, then it would not be reasonably foreseeable that the municipal decision will have a material financial effect on these entities. If that is the case, you would not be disqualified from participating in the decision.

F. Financial Interest in Contract

In addition to the general conflict of interest rules set forth above, the City's Ethics Ordinance contains a prohibition against City Officials being financially interested in any contract made by them in their official capacity. SDMC § 27.3560(a). In addition, SDMC section 27.3560 does not permit the City Council to enter into a contract if any member of the City Council has a prohibited conflict, even if the conflicted official recuses himself or herself from participating in the decision. SDMC § 27.3560(b). These provisions are modeled after California Government Code section 1090, and incorporate all of state law's "remote interest" and "non-interest" exceptions, which are set forth in Government Code sections 1091 and 1091.5, respectively.

As you know, the City Council may proceed with a contract even if one of its members have an interest in the contract so long as the interest is only a "remote interest" and the member discloses that interest on the record and the remaining members of the City Council authorize the contract without the participation of the conflicted member. It does not appear, however, based on the limited facts you provided, that any "remote interest" exceptions are applicable to your spouse's ownership of stock in Citigroup and Lehman Brothers Holdings.

³ Although less relevant in light of the type of involvement Citigroup or Lehman Brothers Holdings appear to have in the subject decisions, you may also adapt the question for the \$2.5 million threshold (is it likely the company would incur or avoid expenses in this amount?) and the other \$10 million threshold (is it likely the company would increase or decrease in value by this amount?).

In addition, some interests are deemed “non-interests” and allow the City Council to approve the contract even with the participation of the member with the financial interest. A non-interest exception that may be applicable to your spouse’s ownership of stock is set forth in California Government Code section 1091.5(a)(1). This provision states that an officer or employee shall not be deemed to be interested in a contract if his or her interest is “the ownership of less than 3 percent of the shares of a corporation for profit, provided that the total annual income to him or her from dividends, including the value of stock dividends, from the corporation does not exceed 5 percent of his or her total annual income, and any other payments made to him or her by the corporation do not exceed 5 percent of his or her total annual income.”

Based on the above, you may apply a three prong test to your spouse’s ownership of stock in Citigroup and Lehman Brothers Holdings. You would not have a prohibited financial interest in a contract with these business entities if (1) you and your spouse owned less than 3 percent of the shares issued for each company; (2) the total annual income you and your spouse receive from the dividends of each company do not exceed 5 percent of your total annual income; and (3) the total annual income you and your spouse receive from any other payments from each company do not exceed 5 percent of your total annual income. Although it appears that the first prong may be met given the enormous number of shares issued by these business entities, we have no facts regarding your total annual income and therefore can make no determinations regarding the other two prongs. Ultimately, if you determine that all three prongs of this test are met, then SDMC section 27.3560 would not prevent you from participating in City contracts with these entities.

If you are unable to meet all three prongs of the test under Government Code section 1091.5(a)(1), then you would have an impermissible financial interest in any contract the City has with the subject business entities. If that is the case, not only would you be precluded from participating in the decision to contract with these entities, but significantly, the City Council would be precluded from contracting with those entities as well. Under such circumstances, the City Council would be legally prohibited from contracting with Citigroup or Lehman Brothers Holdings until your spouse divested herself of her stock in those companies or you left office.

CONCLUSION

Your spouse’s ownership of a substantial amount of stock in Citigroup and Lehman Brothers Holdings constitutes a financial interest for you that must be considered when these business entities are involved in municipal decisions. You may not participate in a municipal decision if it is reasonably foreseeable that the decision will have a material financial effect on either of these entities. Whether the financial effect is “material” depends on whether the business entity is “directly involved” (in which case materiality is presumed) or whether it is “indirectly involved” (in which case materiality depends on a particular financial threshold being met). If, for a particular decision, you determine that the financial effect of the decision on either Citigroup or Lehman Brothers Holdings is “material,” then you must disqualify yourself from participating in that decision.

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In addition, with regard to any decision to contract with either Citigroup or Lehman Brothers Holdings, you should perform the three-prong test under Government Code section 1091.5(a)(1). If you determine that your spouse's ownership of stock in these business entities constitutes a "non-interest," then SDMC section 27.3560 would not prohibit your participation in the City Council's decision to enter a contract with them.

Keep in mind that if the subject municipal decision involves a contract, you must perform the two separate and distinct analyses discussed in this letter. Even if you determine that your interest in the Citigroup or Lehman Brothers Holdings stock is a "non-interest" under SDMC section 27.3560 and Government Code section 1091.5(a)(1), your participation in the decision to contract with these entities may still be barred under section 27.3561. Likewise, if you make a determination that the decision would have not a material financial effect on these business entities under section 27.3561, you must still consider whether you have a prohibited financial interest in a contract under section 27.3560.

Please note that this advice letter is being issued by the Ethics Commission solely as technical assistance from a regulatory agency as provided by SDMC section 26.0414(b). It is not to be construed as legal advice from an attorney to a client. Moreover, the advice contained in this letter is not binding on any other governmental or law enforcement agency.

Sincerely,

Cristie McGuire
General Counsel

By: Stephen Ross
Program Manager-Technical Assistance