

BEFORE THE FAIR POLITICAL PRACTICES COMMISSION

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| In the Matter of: |) | |
| |) | |
| Opinion requested by: |) | No. 78-009 |
| John Ferraro, Councilman |) | Nov. 7, 1978 |
| Los Angeles |) | |
| |) | |

BY THE COMMISSION: We have been asked the following question by John Ferraro, President of the Los Angeles City Council, on behalf of three councilmen; Ernani Bernardi, John Gibson and Robert Ronka:

May councilmen who own single-family rental properties vote on or participate in the consideration of a proposed rent control ordinance?

CONCLUSION

The interests of owners of three or fewer rental units will not be affected by rent control decisions in a manner distinguishable from the effect upon a significant segment of the public generally, and therefore are not disqualified. Since each of the councilmen owns only one rental unit, each may participate in and vote on the rent control ordinance.^{1/}

FACTS

The Los Angeles City Council is considering passage of a rent control ordinance which provides that for a six-month period beginning on the effective date of the ordinance, the rent for a residential unit may not exceed the rent in effect on May 31, 1978, for that rental unit. Rents may be increased only when a voluntary vacancy occurs. A vacancy is not voluntary if it is the result of an eviction or the landlord's refusal to renew a lease of periodic tenancy.

^{1/} Because of the need to provide timely advice to Mr. Ferraro and council members in other cities considering rent control, the Commission adopted this conclusion at its September 1978 meeting. However, the supporting analysis in this opinion was not adopted until the Commission's November 7, 1978, meeting.

Residential rental units include single-family dwellings, mobile homes and multiple family dwellings such as apartments, duplexes, etc.

Three Los Angeles city councilmen have financial interests in rental property which would be subject to the ordinance if it were adopted. Councilman Bernardi's wife owns a single-family residence which she rents on a month-to-month basis for \$150. The fair market rental value of the home is estimated to be approximately \$350 per month. Councilman Gibson owns a single-family residence which he rents on a month-to-month basis for \$250. The fair market rental value of the home is estimated to be approximately \$500 per month. Councilman Ronka owns a cottage which is situated on the same parcel as his principal residence and rents the cottage for \$75 a month to a relative. The estimated fair market rental value of the property is approximately \$200-\$250 per month. None of the three councilmen have raised the rents on their rental property since May 31, 1978. The value of each councilman's property exceeds \$1,000.

We have been asked by Mr. Ferraro on behalf of these three councilmen whether they may make, participate in making or use their official positions to influence the proposed rent control ordinance.

ANALYSIS

The Political Reform Act provides in Government Code Section 87100:^{2/}

No public official at any level of state or local government shall make, participate in the making or in any way attempt to use his official position to influence a governmental decision in which he knows or has reason to know he has a financial interest.

An official has a "financial interest" in a decision "if it is reasonably foreseeable that the decision will have a material financial effect, distinguishable from its effect on the public generally" on any real property of the official worth \$1,000 or more. Sections 87103, 87103(b). The last paragraph of Section 87103 specifically states that an official has an interest in real property owned by his spouse.

^{2/} All statutory references are to the Government Code unless otherwise noted.

Each city councilman has an interest in real property worth more than \$1,000 which conceivably could be affected by the proposed rent control ordinance. Whether they must disqualify themselves from participating in the consideration of that ordinance turns upon whether the ordinance will foreseeably and materially affect their rental properties in a manner different from its effect on the public generally.

In the instant case, we need not address the questions of foreseeability and materiality because the rent control ordinance in question will not affect the interests of the three councilmen in a manner distinguishable from its effect on a significant segment of the public generally. Commission regulation 2 Cal. Adm. Code Section 18703 provides:

A material financial effect of a governmental decision on an official's interests, as described in Government Code Section 87103(a) through (d), is distinguishable from its effect on the public generally unless the decision will affect the official's interest in substantially the same manner as it will affect all members of the public or a significant segment of the public. Except as provided herein, an industry, trade or profession does not constitute a significant segment of the general public.

In order to prevent members of homogeneous interest groups from participating in decisions which will affect their own interests, the regulation does not allow members of a single industry to be considered a significant segment of the public.^{3/}

^{3/} Regulation 2 Cal. Adm. Code Section 18703 allows exceptions to the general rule that an industry, trade or profession cannot be considered a significant segment of the public. The one exception which could conceivably be applicable here is subsection (b), which provides:

(b) In the case of any other elected official, an industry, trade or profession of which that official is a member may constitute a significant segment of the public generally if that industry, trade or profession is a predominant industry,

(continued next page)

We must first determine whether or not the residential rental property business can be characterized as an "industry." That business certainly has some attributes of an industry. Persons involved in the rental property business for the most part earn their income in a similar manner and share distinct and common interests which may be affected by government regulation. On the other hand, the rental property business differs from most other businesses in that the persons engaged in it are a very diverse group, many of whom are not economically tied to the common interests of the business. Despite the diversity of the group involved in the business, it is our belief that the residential rental property business has sufficient attributes of an industry to be characterized as such.

Although we believe the residential rental property business constitutes an industry, we do not believe it necessarily follows that all persons participating in that business are members of that industry. Persons owning large numbers of rental units or whose primary business activity revolves around ownership and management of rental property clearly can be said to be part of the class that makes up the industry. They are persons who are more likely than not to be most concerned with protecting and benefiting the common business interests of the industry.

(footnote ^{3/} continued)

trade or profession in the official's jurisdiction or in the district represented by the official.

Obviously, landlords constitute an important industry in the City of Los Angeles. However, we do not think landlords or any other industry are "predominant" within the meaning of 2 Cal. Adm. Code Section 18703. That provision was included in the regulation in order to avoid disqualification in such cases as a farmer elected in a rural community in which agriculture is the major industry. See, e.g., Gonsalves v. City of Dairy City, 265 Cal. App. 2d 400 (1968).

The regulation, in subsection (a), permits an industry, trade or profession to be considered a significant segment of the public in the case of an elected state officer. Therefore, with respect to rent control decisions made by the Legislature, the rental property industry can be considered a significant segment of the public. See Section 82021.

While those owning large numbers of rental units can be considered part of an "industry," it is difficult to characterize the owner of a small number of units as part of the rental property industry. The small landlord may just rent a room in his home, may have inherited a home from relatives or may have retained ownership of his old home when he moved to a new one. His interest is likely to be incidental and not relied upon as a major source of income. The owners of a small number of rental units are a diverse segment of the population representing all occupations and interests and whose only common bond is the ownership of rental property. Owners of a small number of rental units are analogous to small investors in the stock market. The small investor may occasionally buy and sell stock, but he or she is not part of the securities industry. Likewise, owners of a small number of rental units cannot be considered part of the rental property industry.

While it is relatively easy to conclude that persons owning a large number of rental units are part of the industry and that those who own only one or two units are not, it is much more difficult to determine where to draw the line between those who are and are not part of the industry. Despite the difficulty of drawing such a line, we believe that, in order to provide guidance to public officials as to their responsibilities under the conflict of interest provisions of the Act, it is necessary that such a line be drawn. In analogous situations, the courts have approved the drawing of such lines. See, e.g., Marshall v. United States, 414 U.S. 417, 428 (1974); Oregon v. Mitchell, 400 U.S. 112, 294-95 (1970) (separate opinion of Stewart, J.).

In determining where to draw a line separating members of the industry from other investors, the most relevant and easily applied consideration is how many units the official owns. We think that persons owning three or fewer rental units are most likely small investors only incidentally involved in the real property field. Therefore, we conclude that such persons are not part of the rental property industry. Conversely, we think that the interests of persons owning four or more rental property units are likely to be sufficiently substantial so as to make them members of the rental property industry. We understand that this demarcation between the owners of three and four rental units may lead to anomalous results in certain circumstances. However, on

the whole, we believe that it is a practical and appropriate line between incidental investors on the one hand and active participants in the rental property industry on the other.

Having determined that persons owning three or fewer rental property units are not part of the rental property industry, we turn now to a consideration of whether this group of investors constitutes a significant segment of the public generally. For the very reason that this diverse group of citizens is not a part of the rental property industry, we conclude that it is a significant segment of the public. In order to be considered a significant segment of the public, we think a group usually must be large in numbers and heterogeneous in quality. The class of persons owning three or fewer units meets both these standards and therefore constitutes a significant segment of the general public. As stated previously, this diverse group of citizens contains members from virtually every occupation and interest group in the state. Just as small investors in the stock market would be deemed a significant segment of the public despite the common thread of stock ownership, we believe this collection of small investors in the rental property industry constitutes a significant segment of the public.^{4/} This decision is consistent with our previous determination in the matter of William C. Owen, 2 FPPC Opinions 77 (No. 76-005, June 2, 1976), in which we concluded that homeowners in the redevelopment area of Davis constituted a significant segment of the public because of their diverse nature and lack of group identity.

^{4/} Obviously, persons owning stock in a single company cannot be considered to be a significant segment of the public. However, all persons who own small amounts of common stock in California would be a significant segment of the public with respect to a decision affecting all owners of common stock. Therefore, a person owning stock in Widget Corporation would be disqualified from participating in decisions materially affecting the company. However, a person owning stock in Widget Corporation would not be disqualified from participating in a decision such as one involving a change in the tax imposed upon corporate dividends, which affects all or most owners of common stock in California in the same manner.

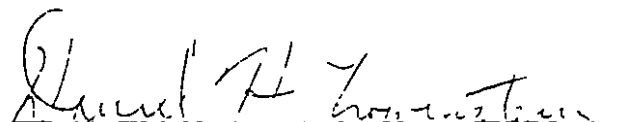
The proposed rent control ordinance will affect all owners of three or fewer rental units in much the same manner. Each owner is subject to a six-month freeze in rents and a rollback to May 31, 1978, rents. Therefore, we also conclude that the effect of the rent control proposal upon the interests of the three councilmen is not distinguishable from its effect upon all owners of three or fewer units, a group we have concluded constitutes a significant segment of the public generally.

In summary, as we construe it, the public generally doctrine means that an official who owns three or fewer residential units may participate in decisions affecting his financial interests because a large number of citizens who are not part of a common industry, trade, profession or other homogeneous group will be similarly affected.

In the instant case, Messrs. Bernardi, Ronka and Gibson each own fewer than three residential rental property units. Accordingly, they may participate in the consideration of the rent control ordinance in question.

Our decision in this matter does not mean that an owner of four or more rental units will automatically be disqualified from participating in rent control decisions. Although the owner of four or more units cannot avoid disqualification through use of the public generally provision of Section 87103, he still may participate in rent control decisions if the circumstances indicate that it is not foreseeable that the decisions will have a material effect on his financial interests. While we believe that in most instances it will be foreseeable that rent control decisions will have a material effect upon the financial interests of the owners of four or more rental units, it is not impossible to imagine situations where a proposed rent control ordinance would not materially affect those interests.

Approved by the Commission on November 7, 1978.
Concurring: Lowenstein, McAndrews and Quinn. Commissioner Lapan abstained. Commissioner Remcho was absent.



Daniel H. Lowenstein
Chairman

Commissioner Quinn concurring:

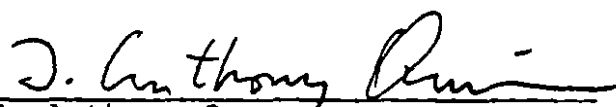
While I do not question the result reached by the majority in this opinion, I believe the reasoning requires amplification. The majority is content to base its ruling on a finding that public official-landlords owning three or fewer rental units constitute a significant segment of the general public, and therefore are not precluded from voting on rent control matters. Public official-landlords who own more than four rental units will be affected differently than the general public, and therefore may not vote on rent control measures.

The line between a conflict and no conflict was arbitrarily drawn at four rental units. I understand the rationale behind this ruling; that a public official-renter may vote on rent control matters. Therefore, a public official-landlord ought to be able to vote unless he is part of a definable landlord industry. Four rental units separate the casual owner of a rental property from those in the rental property industry.

The "public generally" exception, as defined in 2 Cal. Adm. Code Section 18703, is not the only means of permitting the small landlord to vote. I believe a rational case can be made that rent control will have no material financial effect upon the property of a small landlord, while the actual value of property owned by a large landlord may be materially affected by rent control. Evidence suggests that while rent control ordinances will not affect the fair market value of single family or duplex type rental units, they will affect the value of multi-family and apartment units. Most multi-family units have no value other than their ability to produce income. If that ability is curtailed by a rent control ordinance, the value of the units will suffer.

Thus, I believe it is reasonable to find that in many cases a rent control ordinance will have no material financial effect on the value of the units owned by persons with three or less units, but those with four or more units will find a decrease in fair market value as a result of the ordinance. It is at least as reasonable to say this as it is to say, as the majority does, that an owner of three or less units is a member of the general public while an owner of four or more units is a member of the rental industry. We are trying to find a point at which a conflict of interest

occurs and certain owners of rental property should be precluded from voting on rent control matters. It would strengthen this opinion to base that dividing line, in part, on a realization that few if any small landlords will suffer a loss in property value, while those who own a larger number of units will almost certainly suffer a decline in value if a rent control ordinance passes and should be disqualified from voting on them.


T. Anthony Quinn
Commissioner

Commissioner Remcho, concurring:

I concur with the majority's conclusion that the three councilmen should not be disqualified from voting on the Los Angeles rent control ordinance. However, I do not agree with the majority's determination that the councilmen will not be affected in a manner distinguishable from the public generally. In my view, the proper analysis is based on foreseeability and materiality rather than the public generally doctrine.

The Political Reform Act prohibits any public official from participating in a governmental decision "if it is reasonably foreseeable that the decision will have a material financial effect, distinguishable from its effect on the public generally, on..." any interest of the official in real property worth \$250 or more per year. Commission regulation 2 Cal. Adm. Code Section 18703 provides that an effect indistinguishable from an effect on a significant segment of the public will satisfy the "public generally" requirement. However, the regulation also provides that except in instances not pertinent here "an industry, trade or profession does not constitute a significant segment of the general public." The dictionary definition of "industry" which I believe is relevant here is "a group of productive or profit-making enterprises or organizations that have a similar technological structure of production and that produce or supply technically substitutable goods, services or

sources of income."^{1/} According to this definition the important characteristics of an industry are shared profit motive and similarity of enterprise.

The majority's attempt to exempt small rental property investors from status as industry members based on the incidental nature of their holdings departs from this accepted meaning of "industry." Common sense tells us that all rental property owners share these features of profit-motive and similarity of productive activity, no matter how incidental the investment.

In my view, the real issue is whether the decision to be made will have a "material financial effect" on the officials' interest in real property. As of adoption of the formal opinion, 2 Cal. Adm. Code Section 18702(a) provided that a decision would have a reasonably foreseeable material financial effect if:

...in light of all the circumstances and facts known at the time of the decision, the official knows or has reason to know that the existence of the financial interest might interfere with the official's performance of his or her duties in an impartial manner free from bias.^{2/}

Although this rather subjective interpretation leaves much to be desired, it has the advantage of tying disqualification to the statute's ultimate purpose--achieving decision-making unbiased by direct financial interests. Moreover, it provides the flexibility to respond to constitutional demands which are too often overlooked. Our usual tendency is to balance the rights of the public to a decision free of financial influence against the "right" of an officeholder to vote. In such a weighing process, the officeholder will invariably lose the contest before he or she steps on the scales. There is, however, another consideration which must join the rights of the officeholder. For in disqualifying the officeholder, we also effectively disenfranchise those who voted for that officeholder. For example, if a

^{1/} Webster's Third New International Dictionary (unabridged) (1966).

^{2/} The regulation has since been amended and is again noticed for amendment. The reasoning behind my concurrence is not affected by the changes.

big real estate developer is on the city council, he or she is there at least in part because a majority of the officeholder's constituents want a real estate developer on the council. In voting for land development, the officeholder represents his or her constituents.

Disqualification disenfranchises the constituency of the disqualified official. It interferes, however indirectly, with the effective exercise of the constitutionally protected right to vote. As the United States Supreme Court stated in Wesberry v. Sanders, 376 U.S. 1, 17 (1964):

No right is more precious in a free country than that of having a voice in the election of those who make the laws under which, as good citizens, we must live. Other rights, even the most basic, are illusory if the right to vote is undermined.

Although the immediate impact of disqualification is felt by the official rather than by the voters, it is the voters who go unrepresented.

The Commission has also recognized that the effect of unnecessarily interfering with those who seek to serve as public officials cannot be logically distinguished from any other unnecessary burden on the elective process. In the opinion requested by Gilbert T. Boreman, Registrar of Voters, City and County of San Francisco, 1 FPPC Opinions 101 (No. 75-056, Aug. 7, 1975), the Commission found that the Registrar's refusal to accept a declaration of candidacy that failed to include a required disclosure statement was an "interference with the right to seek office." Since alternative remedies were available, the Registrar was required to accept the declaration. See Williams v. Rhodes, 393 U.S. 23 (1968).

The teaching of these cases is that officeholders should not be disqualified if less restrictive means are available to serve the purpose of unbiased decision-making.

A. Foreseeability. The rent control ordinance will have a foreseeable effect on the income produced by the rental property of the councilmen. The ordinance is explicitly directed at regulating such income by requiring a rollback of all residential rents to May 31, 1978, levels and a six-month freeze on any increases. No councilman has raised rents since May 31; none would be affected by the rent rollback.

However, since many landlords have raised rents since May 31,^{3/} it is reasonable to assume that the three councilmen, along with other landlords, have plans to raise rents in the near future. It seems especially appropriate to make this assumption regarding the councilmen because all three now rent their properties at substantially less than fair market value and, consequently, have presumably greater than average motivation to raise rents and fewer countervailing market forces that would prevent them from doing so. The six-month rent freeze would prevent such increases, thereby foreseeably affecting this source of income.

Councilman Bernardi has stated for the record that he will not, in any event, raise rents for six months. It may be argued that the relatively short effective period of the ordinance suggests that a public expression of such intent is reliable and allows a conclusion that Councilman Bernardi's income from rental property will not be foreseeably affected by the rent freeze. If the vote on the proposed rent control ordinance could really have only a six-month effect, this might be an acceptable conclusion. However, defeat of the ordinance will necessarily have a decisive impact on prospects for long-term restrictions on rent increases. Consequently, Councilman Bernardi's decision not to raise rents for six months in no way removes the foreseeable long-term effect that defeat of rent control would have on his rental property income.

B. Materiality. This brings us to the crucial issue of the materiality of the foreseeable effect on the financial interest.

The Political Reform Act does not define materiality, but Section 81003 and the Commission regulations should be read in light of both the constitutional considerations discussed above and the Findings and Declarations and Purpose

^{3/} See, e.g., from the Los Angeles Times: June 30, 1978, §I, p. 32, "Sherman Oaks Tenants Consider Rent Strike After Recent Increases" July 17, 1978, §I, p. 3, "Irate Senior Citizens Protest Post-Prop 13 Rent Increases" July 31, 1978, §I, p. 1, "Rising Rents Cause Anger and Frustration Among California Tenants."

of the Act, which call for disqualification "in appropriate circumstances" in order that conflicts of interest may be avoided.^{4/}

In short, the Act calls for a flexible standard in which an officeholder and his or her constituents will be disenfranchised only where the conflict of interest is indeed material. At the same time, however, officeholders are entitled to some guidelines in making the judgment as to whether they should vote. The guidelines in 2 Cal. Adm. Code Section 18702(b) offer a starting position, but should not be blindly followed.

The relevant guidelines suggest disqualification:

(2) In the case of any real property in which the public official has a direct or indirect interest worth more than one thousand dollars (\$1,000):

(a) Whether the effect of the decision will be to increase the income-producing potential of the real property by \$100 or five percent per month, whichever is less;

(b) Whether the effect of the decision will be to increase or decrease the fair market value of the real property by \$1,000 or more or by .5 percent, whichever is greater.

^{4/} Section 81001(b) provides:

Public officials, whether elected or appointed, should perform their duties in an impartial manner, free from bias caused by their own financial interests or the financial interests of persons who have supported them;...

Section 81002(d) provides:

Assets and income of public officials which may be materially affected by their official actions should be disclosed and in appropriate circumstances the officials should be disqualified from acting in order that conflicts of interest may be avoided;...

The only evidence we have been offered suggests that the foreseeable effect of the ordinance on property values is both speculative and negligible. I cannot, with any confidence, assume that such an effect would meet the dollar amounts suggested by the guidelines.

The ordinance, however, almost certainly would affect income produced by rental property by five percent per month. It is a rare rent increase that does not exceed five percent. The ordinance, by preventing such foreseeable increases, would have the effect of decreasing income by five percent per month, thereby bringing the councilmen within the dollar amount guidelines.^{5/}

However, such a determination should not end the inquiry. Section 18702(p) provides that the "specific dollar or percentage amounts ... do not constitute either absolute maximum or minimum levels, but are merely intended to provide guidance and should be considered along with other relevant factors in determining whether a financial interest may interfere with the official's exercise of his or her duties in rendering a decision." The circumstances here suggest that the minimal holdings in rental property will not interfere with an unbiased decision.

The citizens of Los Angeles have demonstrated considerable interest in the ordinance. This interest is reflected in the extensive media coverage rent control has received in the Los Angeles area.^{6/} The ballot argument for Proposition 9 expresses concern that powerful interests

^{5/} Actually, the regulation speaks only of in-
creasing value, not decreasing it. A literal reading would make it totally inapplicable here. The intent of the Commission was doubtless otherwise.

^{6/} The Los Angeles Times alone had the following coverage of rent control from June 6 through August 30, 1978:

June: Nine articles on rent control in general.

July: Seven articles, one editorial and seven letters to the editor on the Los Angeles rent control ordinance; 14 articles, one editorial and 11 letters to the editor on rent control in general.

August: Nine articles, three editorials and four letters to the editor on the Los Angeles rent control ordinance; 11 articles and one editorial on rent control in general.

continue to dominate "because the business of politics is usually conducted in secret."^{7/} The political business of rent control in Los Angeles is hardly being conducted in secret. Media coverage motivated by public concern has resulted in an "informed, interested and involved electorate" on rent control.^{8/}

The media coverage has also made the councilmen aware of the close attention being paid by their constituents. Furthermore, the small financial holdings of each which might affect his vote on rent control is a matter of public record^{9/} and public discussion.^{10/}

Under these circumstances, what incentive do the councilmen have to disregard the interests of the public in favor of personal interests?

I would think very little. These three are not powerful rental property industry members whose main source of income is related to their property holdings. They are relatively small investors who stand to gain little financially, but lose a lot of constituency support if they ignore the will of the voters on rent control.

In situations such as this one, where public interest and awareness is demonstrably substantial and the financial interest affected so slight, the effect of the governmental decision on the financial interest is immaterial within the meaning of the Political Reform Act. In such circumstances, disclosure is sufficient to assure a bias-free governmental decision-making process. Disqualification,

^{7/} Argument in Favor of Proposition 9, November 1974 Ballot Pamphlet.

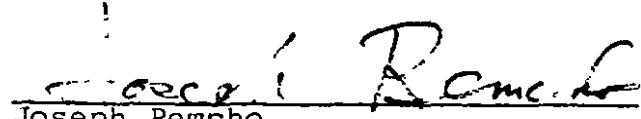
^{8/} See Consumers Union of the United States, Inc. v. California Milk Producers Advisory Board, 82 Cal. App. 3d 433, 443 (1978).

^{9/} FPPC Form 721: "Statement of Economic Interests"

^{10/} Los Angeles Times, July 27, 1978, §II, p. 1: "Some Los Angeles Councilmen May be Ineligible to Vote."

being unnecessary, is inappropriate both under the Political Reform Act and under the constitutionally protected right of the people to participate in the elective process.

I therefore agree with the majority that the councilmen here may vote. I would limit the opinion to the facts of this case, however, and not say that in all circumstances a person with three or less units may vote. Nor would I say that in all circumstances a person with four or more units may not.



Joseph Remcho
Commissioner