



STATE OF CALIFORNIA
FAIR POLITICAL PRACTICES COMMISSION
1102 Q Street • Suite 3000 • Sacramento, CA 95811
(916) 322-5660 • Fax (916) 322-0886

MEMORANDUM

To: Chair Germond and Commissioners Cardenas, Hatch and Hayward

From: Brian Lau, Acting General Counsel
Sukhi K. Brar, Senior Commission Counsel

Subject: Proposed Amendments to Regulation 18700.2 - Parent, Subsidiary, Otherwise Related Business Entity: Defined.

Date: August 6, 2018

Requested Action and Staff Recommendation

Staff requests and recommends adoption of the proposed amendments to Regulation 18700.2. As proposed, amendments to Regulation 18700.2 will provide clarification on when an official has a financial interest in a parent, subsidiary or otherwise related business entity for purposes of the Political Reform Act's conflict of interest provisions.

Background

The Act's conflict of interest provisions prohibit an official from making, participating in making, or using his or her official position to influence a decision in which the official has a financial interest. (Section 87100.) An official has a financial interest in the decision, if it is reasonably foreseeable the decision will have a material financial effect on the official or on specified interest, including a business entity, in which the official has an investment of \$2,000 or more (Section 87103(a)); a source of income of \$500 or more in the 12 months prior to a decision (Section 87103(c)); and a business entity in which the official is a director, officer, partner, trustee, employee, or holds any position in management (Section 87103(d)).

Historically, the Commission has determined that an official with an interest in a business entity also has an interest in a parent, subsidiary, or related business entity. This is based on the fact that under Sections 82034 and 87209 an "investment" is any financial interest or security interest of more than \$2,000 in a business entity, and a "business position" is any business entity in which the official is director, officer, partner, trustee, employee, or manager, if the business entity, or any subsidiary, or otherwise related business entity does business in the jurisdiction. Former Regulation 18703.1(c) expressly stated that "[a]n official has an economic interest in a business entity which is a parent or subsidiary of, or is otherwise related to, a business entity in which the official has one of the interests defined in [Section] 87103(a) or (d)." However, this language was removed from Commission regulations in 2014.

Current Regulation 18700.2, however, still defines parent, subsidiary, and otherwise related business entities for purposes of Section 82034 and 87209 of the Act. Moreover, in defining various interests under the Act, Regulation 18700 still directs officials with an interest in a business entity to refer to the definition of parent subsidiary, and otherwise related business entity in Regulation 18700.2. (Regulation 18700(c)(6)(A)(C) and (D).) Accordingly, staff has continued to advise that an interest in a business entity may include an interest in a parent, subsidiary, or otherwise related business entity depending on the factual circumstances. (See *Chmura* Advice Letter, No. I-17-051, and *Pelletier* Advice Letter, No. I-17-144.)

The Commission voted to notice proposed Regulation 18700.2 for adoption at its June 21, 2018, Commission Meeting in response to previous concerns that it may not have been clear in an enforcement matter whether a corporation was a parent corporation of the business entity in which the respondent had an interest. More specifically, staff was asked to examine Regulation 18700.2 and whether an official should be disqualified if the parent corporation has not identified the subsidiary or related business in its annual Form 10-K or 20-F Reports with the Securities and Exchange Commission.

Discussion and Summary of Proposed Actions

Staff has drafted proposed amendments to Regulation 18700.2. Specifically, proposed subdivision (d) would establish an exception to the general rule that an official with an interest in a business entity also has an interest in a parent, subsidiary, or otherwise related business entity.

The exception provides that an official does not have an interest in a parent, subsidiary, or otherwise related business if both of the following conditions are met: (1) the official owns less than 5% of the shares of a corporation and is a passive shareholder¹ and (2) the parent corporation is required to file annual Form 10-K or 20-F Reports with the Securities and Exchange Commission and the parent corporation has not identified the subsidiary or related business on those forms or its annual report.

Just as significantly, proposed subdivision (c) is added to the regulation to clearly state that an official with a financial interest in a business entity also has an interest in a parent, subsidiary, or otherwise related business entity except as provided in the above-mentioned exception found in subdivision (d).

Lastly, in the definition of “otherwise related business entities” in subdivision (b)(3)(A) and (B), the phrase “the same person or a majority of the same persons” is replaced with “the same person or persons together” to clarify that business entities are considered otherwise related only when the same person or people own a controlling interest in two or more businesses or the same person or people own 50 percent or more ownership interest in two or more businesses. This would apply to businesses other than a parent corporation as defined in subdivision (b)(1) of the proposed regulation.

¹ A passive shareholder is one that is not an employee or involved in management decisions of the corporation.