

April 1, 2010

TO: San Jose Elections Commission  
FROM: Michael A. Smith, Vice-Chair  
SUBJECT: Proposed Changes to Lobbying Ordinance

## **RECOMMENDATION**

In response to the City Council Referral to consider the issue of "closing a loophole in lobbyist registration and disclosure," I propose that the Elections Commission recommend the following actions:

1. Remove compensated officers or employees of 501(c)(3) nonprofit organizations from the list of those exempt from the requirements of the Lobbying Ordinance;
2. Establish the threshold for the definition of an in-house lobbyist as forty hours of lobbying activity in a consecutive twelve month period for 501(c)(3) organizations (four times the threshold for others); and
3. Exempt 501(c)(3) organizations from having to pay annual lobbyist registration fees.

These recommendations would be implemented by making the following changes to the Lobbying Ordinance (Municipal Code Title 12, Chapter 12.12):

- Delete subsection M. from the list of persons exempt from the requirements of the lobbying ordinance as specified in Section 12.12.020:

~~M. Compensated officers or employees of a nonprofit organization with tax exempt status under Section 501(c)(3) of the Internal Revenue Code whose attempts to influence governmental action are on behalf of the organization.~~

- Revise the definition of in-house lobbyist as specified in subsection B. of Section 12.12.180 as follows:

B. In-house lobbyist: Any person, including a business, corporation, association, political action committee, or any other organization if its owners, officers, or employees have engaged in lobbying activity on its behalf and whose aggregate time engaging in lobbying activity total:

1. **forty hours or more in a consecutive twelve month period for a nonprofit organization with tax exempt status under Section 501(c)(3) of the Internal Revenue Code whose attempts to influence governmental action are on behalf of the organization; or**

2. ten hours or more in a consecutive twelve month period **for all other persons.**
- Revise subsection B. and add new subsection F. in Section 12.12.440 regarding payment of annual registration fees:
    - B. **Except as specified in subsection F. below, all** ~~All lobbyists are required to register,~~ including expenditure lobbyists or contract lobbyists that work for an in-house lobbyist, **are required to** ~~and~~ pay an annual registration fee at the time of registration or registration renewal. If the lobbyist registers for the first time on or after June 30 of a given year, the lobbyist may pay a reduced registration fee. If the fee is not paid at the time of registration or registration renewal, a late registration fee will be assessed on a daily basis until the registration fee is paid in full. In no event will the late registration fee exceed one hundred percent of the unpaid registration fee.
    - D. **Except as specified in subsection F. below, any** ~~Any~~ lobbyist who fails to file a quarterly report or files a quarterly report after the report is due under Section 12.12.430 will be assessed a late filing fee. Interest calculated on a monthly basis or a fraction thereof will accrue on the late filing fee from the date the fee is due to the date the fee is paid. If more than one fee is due, interest will accrue separately upon each fee.
    - F. **Nonprofit organizations with tax exempt status under Section 501(c)(3) of the Internal Revenue Code whose attempts to influence governmental action are on behalf of the organization are exempt from the requirements of this section unless otherwise specified.**

## **BACKGROUND**

The San Jose City Council referred the issue of "closing a loophole in lobbyist registration and disclosure" to the Elections Commission on December 15, 2009. This issue was identified as Recommendation #2 in the 2009 Mayor's Biennial Review of Ethics Ordinances (memos dated November 24, December 4 and December 14, 2009). Since that time, the Elections Commission has discussed the issue and heard public comment at two separate meetings.

In addition to attending/observing City Council deliberations on December 15, 2009 and participating in Elections Commission deliberations on February 10 and March 22, 2010, I have reviewed a number of documents relating to the proposed change to the Lobbying Ordinance, including:

- Memos from Mayor Chuck Reed to the City Council, dated November 24, December 4 and December 14, 2009
- Memo from Councilmembers Ash Kalra, Nancy Pyle and Kansen Chu to Mayor Chuck Reed and the City Council, dated December 11, 2009
- Memo from City Attorney Richard Doyle/Sr. Deputy City Attorney Lisa Herrick to the Elections Commission, dated February 3, 2010
- Memo from Mayor Chuck Reed to the Mayor's Biennial Ethics Review Panel Participants, dated February 16, 2010

- Memos submitted to the Elections Commission by various members of the public
- Municipal Code Title 12, Chapter 12.12
- Meeting agendas, attachments and minutes available on the City website for the April-June, 2004 meetings of the 2004-2005 Blue Ribbon Task Force on Ethics Ordinance
- *San Jose Mercury News* editorial, "Lobbyist or not, it's disclosure that matters," dated December, 28, 2009
- Internal Revenue Service (IRS) forms/instructions for Form 990 (Return of Organization Exempt from Income Tax) and Schedule R (Related Organizations and Unrelated Partnerships)
- Fair Political Practices Commission (FPPC) Regulations (Title 2, Division 6, California Code of Regulations), Section 18703.1 (Economic Interest, Defined: Business Entities)

The specific issue identified in the Mayor's Biennial Ethics Review was that "organizations and businesses that are subject to our lobbyist registration and disclosure requirements should not be able to form nonprofit organizations to engage in lobbying, thereby having their lobbying efforts hidden from public scrutiny" since "currently, paid employees of nonprofit organizations with tax-exempt status under Internal Revenue Code section 501(c)(3) are exempt from registering under the City's lobbying ordinance." The proposed action was to change the Lobbying Ordinance to narrow the lobbyist registration exemption for 501(c)(3) nonprofit organizations by requiring the registration of officers and employees of a 501(c)(3) organization engaged in lobbying activity *if it is controlled by an entity that is already required to register* as a lobbying organization. The definition of control would be:

- a. The other entity directly or indirectly appoints or selects members of the Board of Directors, officers or employees of the nonprofit; or
- b. The same person or organization manages or directs the nonprofit and the other entity; or
- c. The other entity and the nonprofit commingle assets, employees or expenses.

This proposal has elicited criticism from some Councilmembers and members of the public, with the primary points of concern being that: (1) the definition of "control" is broader than the established IRS definition contained in the instructions for IRS Form 990; and (2) the proposal is perceived by some as being targeted at one specific organization, Working Partnerships USA.

In studying the available information regarding the proposed changes to the Lobbying Ordinance, I have three specific concerns:

1. Since the 501(c)(3) concept is wholly a creation of the US tax code and associated IRS regulations, I feel that it is essential to consistently use the established IRS terminology, such as the definition of "control," in characterizing and regulating the activities of 501(c)(3) organizations.
2. I believe the proposal has been "tainted" in the public's mind due to allegations that its purpose is to "punish" Working Partnerships USA.
3. While I agree with the Mayor's assertion that there is a "loophole" in the Lobbying Ordinance, I would characterize the loophole more broadly than he has.

In his memo dated February 16, 2010, Mayor Reed identified the public policy issue concerning the lobbyist registration exemption for 501(c)(3) organizations as follows: "The public policy problem with this exemption is that it created a loophole. Now that the loophole has been demonstrated, others can use it. Any organization required to register under the lobbying ordinance can create a 501(c)(3) organization, conduct its lobbying activity through its 501(c)(3), and not report that lobbying activity."

My evaluation of the public policy issue starts with the stated purpose of the Lobbying Ordinance per subsection B. of Municipal Code section 12.12.010. Factoring in the definitions of lobbyist (section 12.12.180) and lobbying activity (section 12.12.170), the primary purpose of the Lobbying Ordinance can be restated "in plain English" as follows:

In the spirit of open and transparent government, the purpose of the Lobbying Ordinance is to allow the public to know and better understand the relationship between its elected officials and any persons, including businesses, corporations, associations, political action committees, or any other organizations, influencing or attempting to influence city officials or city officials-elect with regard to legislative or administrative actions of the city or redevelopment agency.

I believe the public policy issue becomes clear when comparing the actual provisions of the Lobbying Ordinance to its stated purpose. Specifically, I believe the blanket exemption from requirements for lobbyist registration and disclosure granted to 501(c)(3) organizations is a loophole in and of itself, independent of issues of "control." I do not see any logical basis for such a blanket exemption if the purpose of the Ordinance is truly "to allow the public to know and better understand..." In this context, the findings of a survey conducted by the City Attorney's office should be noted:

- A nonprofit organization must register as a lobbyist in San Diego, San Francisco, Sacramento or Oakland if the registration threshold is met.
- A nonprofit organization must register as a lobbyist in Los Angeles if the registration threshold is met unless it is a 501(c)(3) organization that receives government funding and provides direct representation services to indigent persons free of charge. However, the exemption does not extend to an attempt to influence a decision regarding funding that an organization seeks from the city on its own behalf.
- A member or employee of a nonprofit organization is exempt from registration in Fresno when representing the organization for the sole purpose of promoting the interest of the nonprofit, unless the employee is engaged primarily in lobbying services for the nonprofit organization.

After evaluating the public policy issue and reviewing the survey of lobbying regulations in other California cities, I believe that a blanket exemption from lobbyist registration and disclosure for 501(c)(3) organizations cannot be justified and should be abolished. However, I am not advocating that all 501(c)(3) organizations engaging in any level of lobbying activity be forced to register as lobbyists. As in the for-profit world, there are many different types of organizations within the nonprofit community, including significant variations in size, scope and types of activities. Thus, I am not proposing that the Lobbying Ordinance be revised to impose

lobbyist registration and disclosure requirements on the smaller and more narrowly focused 501(c)(3) organizations that occasionally engage in lobbying activity related to their specific missions. Rather, I think the scope of applicability of lobbyist registration and disclosure requirements should be expanded to capture the larger and more broadly engaged 501(c)(3) organizations that are a regular presence and appear to wield considerable influence at City Hall. Thus, my proposal has three parts: (1) eliminate the lobbyist registration exemption for 501(c)(3) organizations; (2) establish a higher registration threshold for 501(c)(3) organizations; and (3) eliminate annual registration fees for 501(c)(3) organizations.

The intent of the higher lobbyist registration threshold I am proposing for 501(c)(3) organizations is to limit the registration requirements to those few organizations most actively involved in lobbying activity. I have not conducted a significant amount of research to support the specific threshold value being proposed (40 hours or more in a consecutive twelve month period), and perhaps some additional research should be performed before forwarding any such recommendation to the City Council. My feeling is that the registration threshold for 501(c)(3) organizations should be somewhere between the current threshold for all persons (ten hours or more in a consecutive twelve month period) and the former (pre-2007) threshold of 20 hours or more within any three month period (equivalent to 80 hours in a twelve month period). The intent of eliminating annual lobbyist registration fees for 501(c)(3) organizations is to remove the direct financial burden of registration in recognition of the unique character of these organizations.