STATE OF CALIFORNIA
FAIR POLITICAL PRACTICES COMMISSION
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March 19, 2021

Shannon L. Chaffin
City Attorney
Aleshire & Wynder LLP
2440 Tulare Street, Suite 410
Fresno, CA 93721

Re: Your Request for Advice
Our File No. A-21-034

Dear Ms. Chaffin:

This letter responds to your request for advice regarding the Political Reform Act (the "Act") and Government Code Section 1090, et seq.[1] Please note that we are only providing advice under Section 1090, not under other general conflict of interest prohibitions such as common law conflict of interest, including Public Contract Code.

Also, note that we are not a finder of fact when rendering advice (*In re Oglesby* (1975) 1 FPPC Ops. 71), and any advice we provide assumes your facts are complete and accurate. If this is not the case or if the facts underlying these decisions should change, you should contact us for additional advice.

We are required to forward your request regarding Section 1090 and all pertinent facts relating to the request to the Attorney General's Office and the Sutter County District Attorney's Office, which we have done. (Section 1097.1(c)(3).) We did not receive a written response from either entity. (Section 1097.1(c)(4).) We are also required to advise you that, for purposes of Section 1090, the following advice "is not admissible in a criminal proceeding against any individual other than the requestor." (See Section 1097.1(c)(5).)

QUESTION

Do the conflict provisions of the Political Reform Act or Government Section 1090 prohibit City Manager Dave Vaughn from taking part in decisions concerning a potential amendment to the current Franchise Agreement between the City and Recology given Mr. Vaughn was a former employee and defined contribution plan participant of Recology?

[1] The Political Reform Act is contained in Government Code Sections 81000 through 91014. All statutory references are to the Government Code, unless otherwise indicated. The regulations of the Fair Political Practices Commission are contained in Sections 18110 through 18997 of Title 2 of the California Code of Regulations. All regulatory references are to Title 2, Division 6 of the California Code of Regulations, unless otherwise indicated.

CONCLUSION

No. As explained below, neither the Act nor Section 1090 would prohibit Mr. Vaughn from taking part in such decisions.

FACTS AS PRESENTED BY REQUESTER

You are the City Attorney for Yuba City. At its February 2, 2021 regular meeting, the City Council appointed Dave Vaughn as City Manager, effective February 22, 2021. Mr. Vaughn was previously an employee for Recology, a solid waste and recycling company, which does business in the City. Specifically, following a request for proposals in November 2017, the City selected Recology as its solid waste and recycling provider and, on October 2, 2018, entered into an exclusive franchise agreement ("Franchise Agreement") for these services.

Mr. Vaughn left Recology in May 2019. Subsequently, Recology and the City entered into an amendment to the Franchise Agreement in or about August 20, 2019 to help align the City's contract with those of the other Regional Waste Management Authority jurisdictions and provide for biosolids disposal. The parties anticipate entering into additional amendments to the Franchise Agreement, the most recent of which is anticipated to be within the next few months to address compliance with the State's organics waste mandates under SB 1383.

Recology employs approximately 3,000 employees, with revenues of approximately $1.2 billion. The company is 100% employee-owned through an employee stock ownership plan ("ESOP"), which is a defined contribution plan that is administered by Recology as the Plan Administrator. Based on the Summary Plan Description of the ESOP, the ESOP qualifies under Section 401(a) of the Internal Revenue Code. When an employee leaves Recology and takes a position with another employer that the employee believes creates a conflict of interest were the employee to continue to have stock, Recology will convert the employee's stock into cash.

The non-Recology investments held by the ESOP are held by a separate trust (they are not held by Recology) and are not subject to recapture by Recology under any circumstances. They belong to the former employee exactly the same as the investments held in trust under the 401(k) for the former employee. The money invested in other assets has no impact on the well-being of Recology. Whether Recology makes or loses money on the Franchise Agreement with the City has no effect on the value of the non-Recology investments held by the ESOP trustee. Performance of the work under the Franchise Agreement with the City (or any other agreement) will not affect the value of Mr. Vaughn's ESOP account, nor will it have any effect on the ability of the ESOP trustee to pay out the funds due to him when they are due to be paid.

Mr. Vaughn is concurrently requesting divestment of his Recology stock, as with similar situations in the past where an employee accepted an offer from a new employer that required them to divest from Recology stock. Following the processing of his request, he will be fully divested out of Recology stock in what is referred to as OIA (Other Investment Accounts), which is like investing his money in the outside stock market. This will be done through a brokerage account which is not tied to Recology stock, and therefore not impacted by the profitability of Recology. Performance of Mr. Vaughn's ESOP account, once in the OIA, is driven entirely by the stock market and his investment choices.

Mr. Vaughn left Recology in May 2019. Following the termination of his employment, he no longer receives additional compensation or shares of Recology stock. During his tenure with Recology, Mr. Vaugh was an administrator of the Recology ESOP. He is no longer involved in the administration of the ESOP. Mr. Vaughn's interest in Recology ESOPs exceeds $25,000. However, it represents less than 1 percent of the shares of Recology. As an employee of Recology, Mr. Vaughn actively participated on behalf of Recology in the formulation of the proposal by Recology in response to the City's November 2017 request for solid waste and recycling services to the City. He also actively participated on behalf of Recology in the negotiation of the Franchise Agreement with the City. The negotiations were part of his regular job duties in his position as Vice President and Senior Director of Operations. His last position at Recology was Senior Director, Vice President of Business and Market Development.

ANALYSIS

The Act

Under Section 87100, a public official may not make, participate in making, or use his or her official position to influence a governmental decision in which the official has a financial interest. A public official has a "financial interest" in a governmental decision, within the meaning of the Act, if it is reasonably foreseeable that the decision will have a material financial effect on one or more of the public official's interests. (Section 87103; Regulation 18700(a).)

Section 87103 identifies interests from which a conflict of interest may arise and, potentially applicable to the present situation, includes:

- Any business entity in which the public official has a direct or indirect investment worth $2,000 or more. (Section 87103(a).)

- Any source of income, except gifts or loans by a commercial lending institution made in the regular course of business on terms available to the public without regard to official status, aggregating $500 or more in value provided or promised to, received by, the public official within 12 months prior to the time when the decision is made. (Section 87103(c).)

The present situation is similar to the advice we provided in the *Ueda* Advice Letter, No. A-19-073, where we concluded an agency's executive director, who has an ESOP with a former employer, was not prohibited under the Act's conflict of interest provisions from taking part in decisions concerning an agreement between the agency and her former employer. There, we discussed in detail the *Gillian* Advice Letter, No. A-95-304, in which a CalPERS employee had previously worked at a private company where she participated in an employee profit-sharing plan that was a qualified plan under Internal Revenue Code Section 401(a) – specifically, a 401(k) defined contribution plan. Under the plan administered by the company, it had no access to the funds, each participating employee had an investment account and investing in the company itself was not an investment option. The company made contributions to the plan, but the contributions ceased when the employee stopped working. The employee had not received any distribution from this plan at the time she began her employment with CalPERS.

While under employment with CalPERS, the employee's former employer sought the award of a contract from CalPERS. The issue arose as to whether the Act prohibited the employee from participating in the decision based on her financial interest in the defined contribution plan administered by her former employer. The advice letter explained:

> The term "investment" as used above means, in pertinent part, any financial interest in or security issued by a business entity, including but not limited to common stock, preferred stock, rights, warrants, options, debt instruments and any partnership or other ownership interest owned directly, indirectly or beneficially by the public official, or his or her immediate family. The term "investment" does not include a time or demand deposit in a financial institution, shares in a credit union, any insurance policy, interest in a diversified mutual fund registered with the Securities and Exchange Commission under the Investment Company Act of 1940 or a common trust fund which is created pursuant to Section 1564 of the Financial Code. (Section 82034.)
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> The term "income" as used above means, in pertinent part, a payment received, including but not limited to any salary, wage, advance, dividend, interest, rent, proceeds from any sale, gift, loan, etc. The term "income" does not include payments received under a defined benefit pension plan qualified under Internal Revenue Code Section 401(a). (Section 82030.)

In finding that the CalPERS employee did not have a potential conflict based on her interests in, or future payments from, the defined contribution plan, the *Gillian* Advice Letter cites to the *Harris* Advice Letter, No. A-82-207, and advises that neither an interest in a private profit-sharing plan, nor the investments held through it, are "investments" within the meaning of Act if the plan qualifies under Internal Revenue Code Section 401(a). It then stated the advice is consistent with the Act's provision exempting payments under a defined benefit pension plan from the definition of "income."

Here, similar to *Ueda*, in order to avoid a conflict of interest, Mr. Vaughn's stock in Recology, through the ESOP administered by Recology and qualified under Internal Revenue Code Section 401(a), will be converted into cash, held in a separate trust from Recology stock, and invested in non-Recology investments – similar to the investments held in trust under a 401(k) plan for the former employee. Once his request is processed, he will be fully divested out of Recology stock, and performance of his ESOP account, once in the OIA, is driven entirely by the stock market and his investment choices. Therefore, as in the *Ueda* matter, Mr. Vaughn does not have a potential conflict of interest under the Act based on his interests in, or future payments from, the ESOP account.[2]

[2] In addition, because Mr. Vaughn no longer receives compensation or shares of Recology stock as of the termination of his employment with Recology in May 2019, he does not have a potential financial interest in Recology as a source of income.

Accordingly, the Act's conflict of interest provisions would not prohibit Mr. Vaughn, as the City Manager, from taking part in decisions concerning any amendments to the current Franchise Agreement between the City and Recology.

Section 1090

Section 1090 generally prohibits public officers, while acting in their official capacities, from making contracts in which they are financially interested. The prohibition applies regardless of whether the terms of the contract are fair and equitable to all parties. (*Thomson v. Call* (1985) 38 Cal.3d 633, 646-649.) Section 1090 is concerned with financial interests, other than remote or minimal interests, that prevent public officials from exercising absolute loyalty and undivided allegiance in furthering the best interests of their agencies. (*Stigall v. Taft* (1962) 58 Cal.2d 565, 569.)

The determinative issue here is whether Mr. Vaughn has a prohibitive financial interest in the potential amendments to the current Franchise Agreement between the City and Recology.

Under Section 1090, "the prohibited act is the making of a contract in which the official has a financial interest." (*People v. Honig*, *supra*, at p. 333.) Officials are deemed to have a financial interest in a contract if they might profit from it in any way. (*Ibid*.) Although Section 1090 does not specifically define the term "financial interest," case law and Attorney General opinions state that prohibited financial interests may be indirect as well as direct, and may involve financial losses, or the possibility of losses, as well as the prospect of pecuniary gain. (*People v. Vallerga* (1977) 67 Cal.App.3d 847, 867, fn. 5; *Terry v. Bender* (1956) 143 Cal.App.2d 198, 207-208; 85 Ops.Cal.Atty.Gen. 34, 36-38 (2002); 84 Ops.Cal.Atty.Gen. 158, 161-162 (2001).)

Here, Mr. Vaughn will not profit in any way from an amendment to the current Franchise Agreement between the City and Recology. According to the facts, Mr. Vaughn's non-Recology investments held by the ESOP will be held by a separate trust (not by Recology) and will not subject to recapture by Recology. The money he invests in other assets will have no impact on the well-being of Recology. In the same vein, whether Recology makes or loses money on the current Franchise Agreement with the City will have no effect on the value of his non-Recology investments held by the ESOP trustee. Finally, performance of the work under the Franchise Agreement with the City (or any other agreement) will not affect the value of Mr. Vaughn's ESOP account, nor will it have any effect on the ability of the ESOP trustee to pay out the funds due to him when they are due to be paid.

Accordingly, Mr. Vaughn does not have a financial interest under Section 1090 in the potential amendments to the current Franchise Agreement between the City and Recology.

If you have other questions on this matter, please contact me at (916) 322-5660.

Sincerely,

Dave Bainbridge
General Counsel

By: Jack Woodside
Jack Woodside
Counsel, Legal Division

JW:aja