July 8, 2002

Chairman Getman and
Commissioners Downey, Knox & Swanson
Fair Political Practices Commission
428 J Street, Suite 450
Sacramento, CA 95814

VIA FACSIMILE
916-322-6440
10 pages including cover

Dear Commissioners:

Thank you in advance for your consideration of my request for an opinion overturning the two staff advice letters in this matter. Unfortunately, a public hearing by another governmental body that I must attend eliminates the possibility of my appearing before you in person on July 11, 2002 to speak on my behalf.

Please accept the following written comments as my statement in response to the latest memorandum prepared by the Commission staff.

I hope that you will come to agreement with my position, which I believe is based on a simple and correct interpretation of both the facts and the relevant regulations.

Sincerely,

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Director, Peninsula Healthcare District

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I. Background

In November 2000, I was elected as a director of the Peninsula Healthcare District. I was well aware of the contentious history of lease negotiations between the District and the operator of the District's hospitals, Mills Peninsula Health Services (MPHS, a Sutter Health Affiliate). Prior to my election, I carefully reviewed the FPPC guidelines regarding conflict of interest (including Section 18703.3(a), (b), and (c)) because of my employment in the pharmaceutical industry. I was confident that no conflict existed since I did not make a commission income as defined in 18703.3(c) and my employer, the relevant source of income as defined in 18703.3(a), was not MPHS or any other party before the District but was Baxter Healthcare Corporation, a multibillion dollar, multinational Fortune 500 company located outside of the District. I do receive an incentive compensation bonus which is based on a complex formula that compares sales of various products across an entire region (not specific transactions from a single customer such as MPHS) with a sales forecast budget determined by my employer, and based on numerous calculations and factors in combination generates a monthly and yearly lump sum payment.

After taking office, I became involved in the negotiations with MPHS regarding their proposed construction of a new $350 Million hospital to be privately run on District land under a 50-year lease (with a 50 year option to renew) in exchange for $1.00 (one dollar). I squared off against MPHS and its parent company, seeking to maintain public access, oversight, and vital services for the community who owned the land. After my point of view became known, mysterious rumors surrounding potential conflicts of interest by District directors based on their employment and/or income began to circulate in the community. Anxious to avoid the history of legal conflict that had entangled previous District boards, my colleague, Director Tobin Schneider, M.D. (who receives some income from MPHS through emergency room services reimbursements), and I voluntarily sought advice letters from the FPPC (a third Director, Vince Muzzi, later voluntarily disqualified himself from participating in the lease negotiations without seeking an advice letter due to his ownership of property next to the proposed hospital site. This action, combined with the results of the two Staff advice letters, would lead to a majority of the District directors being incapable of voting on this vital issue).

I voluntarily sought an advice letter from the FPPC to avoid even the appearance of a conflict of interest. I remain convinced that, based on the law and the facts at hand, no conflict exists. I was surprised, but not worried, when the first advice letter ("Coffey") warned that a conflict might exist due to my incentive compensation bonus. After reviewing the first advice letter carefully and consulting with legal counsel familiar in detail with FPPC regulations, I felt that the statute and regulation regarding commission income as a source of income had been misinterpreted in my case and sought a review of the Staff opinion. This led to the second advice letter, ("Brown"), which confirmed that my incentive

compensation bonus was not commission income. However, the second advice letter still determined that a conflict might exist based on the concept of "like a commission." Since this finding went beyond interpretation of existing statute and regulation and ventured into the making of new regulations, I appealed the second advice letter to the full FPPC for a hearing and opinion.

After the June 7, 2002 FPPC meeting, I felt deeply hurt that my coming forward voluntarily to clear my good name turned into a confrontational hearing that seemed to have predetermined me guilty of conflict of interest, and would result in the Commission directing its staff to then find the reasons to support the presumption of my guilt. This unexpected behavior casts a pall over any other elected official voluntarily coming forward to seek advice from the FPPC and is just plain wrong.

I still feel that the FPPC staff advice is wrong based on interpretation of statute and regulation as applied to the facts in this case; through tortured logic the latest Memo ventures into the creation of at least four new standards for determining sources of income that are not defined in statute or regulation and will prove impossible to be fairly and equitably applied to all elected officials subject to FPPC regulation.

What started as a simple request for clarification of existing regulation has turned into a Kafka-esque exercise in the creation of new regulations on-the-fly to fit a desired outcome. This sets a dangerous precedent because the same flawed logical process could be applied to disqualify virtually any elected official who appeared voluntarily before the FPPC. And it is patently unfair since the same adaptive interpretation of statute and regulation would not be applied to other elected officials who chose (some would say "who had the good sense") not to seek advice from the FPPC. For example, yet another Peninsula Healthcare District Board member is a retired MPHS staff physician who receives pension income that could conceivably be attributed to MPHS under the advice and analysis contained in the Coffey and Brown advice letters and Staff opinion memo. Yet this individual refuses to voluntarily request an advice letter from FPPC staff, despite numerous requests by the citizens that he seek your opinion.

I have always tried to represent the people by standing up to the powerful forces of a healthcare giant who wants to run roughshod over our community interests. By trying so hard to show that I was free of any conflict, I have had my voice silenced for over a year, which plays right into the hands of the MPHS-oriented interests who want to negotiate this lease without community oversight. Thus, as will be shown below, you are unwittingly punishing the innocent while allowing the guilty to go free.

II. Analysis of Memo from Commission Staff dated June 26, 2002

Staff has made an extremely troubling leap beyond the clearly defined one-step (or two-party) transactional relationships governing source of income defined in the Act to a broad interpretation that multi-step (or third-party) transactions can be attributed to a two-step entity, making them the equivalent of an employer-customer relationship. Staff itself admits (on page 4, paragraph 2 of their Memo) that none of the concepts of third-party attribution found elsewhere in the Act (which are carefully defined instances of parent/subsidiary or other controlling interest relationships) apply in this case.

Staff then goes on to assert what "the defining principle regarding attribution here should be. . ." (page 5 paragraph 1). Note the emphasis on "should be" rather than "what the Act states. . ." This crosses the line from interpreting existing statute and regulation and ventures into rulemaking without the benefit of the appropriate public comment and review process. The Commission has an obligation to the people of the State of California to uphold the law and follow the designated processes if it wishes to enact new regulation or amend existing regulation.

Staff's further efforts to define "incentive compensation" (page 5 paragraph 2) once again cross the line from interpretation to rulemaking.

The example cited by Staff to support attribution (page 6, paragraph 1; customers buying Maytag appliances at Sears) is also flawed in its analysis. The "individual's" economic relationship is with "Sears" even though they may consider themselves a "Maytag" customer. The fact is that Maytag has no guarantee of learning the individual customer's identity unless they voluntarily identify themselves via the return of a warranty card. Commissioners should ask themselves how frequently they return warranty cards identifying themselves upon purchasing consumer goods from a retailer. Even when the end consumer has been identified, the economic relationships are still separate. Every purchase of a Maytag washer from Sears does not necessarily result in the purchase of another washer by Sears from Maytag. Sears' purchases from Maytag will be influenced by a number of factors, including overall consumer demand, incentives or special offers given from time to time by Maytag to Sears, current inventory and financial conditions, etc. In addition, a competitive dynamic exists where Sears may even switch suppliers from Maytag to Whirlpool, thus severing the economic relationship all together while still maintaining the customer relationship with the individual consumer (in fact, Sears enhances their ability to do just this by marketing the washer to the individual under the house brand "Kenmore" in order to mask the identity of the actual manufacturer from the consumer).

The Sears example cited by Staff does not only fail to support the concept of attribution of income, it does not even correctly map to the relationship between

Baxter Healthcare, its distributors, MPHS, and myself. A more correct interpretation would be that the "individuals" in the example (the physicians who have the ultimate control over purchase decisions and actually initiate orders), shop at a retailer such as Sears (MPHS), which in turn buys from a wholesale distributor who is undefined in this case (in reality a pharmaceutical distributor such as Cardinal or McKesson), who in turn buys from the manufacturer (Baxter). Thus we can see that in order to attribute income to me, we are dealing with not just a third-party transaction, but in fact a fourth-party transaction (customer of a customer of a customer).

A better analogy would be if I were an employee of a dairy, responsible for increasing consumer consumption of milk through educational programs, passing out product samples in grocery stores, etc. My dairy's products are sold to a wholesaler, such as Berkeley Farms, who sells the milk to a retailer, such as Safeway, who then offers its consumers multiple sizes, brands, and flavors of milk from which consumers could make the ultimate purchase decision. Even if Dairy Farmer Hanko were to receive an incentive compensation bonus tied to sales of several varieties of dairy products over the course of the year in the entire northern California region, to attribute a portion of that bonus to any individual consumer purchase is an incorrect expansion of the definition of "source of income." There is no direct connection between a specific sales transaction at Safeway and Farmer Hanko's bonus income. While I may have knowledge in a global sense that sales to Safeway in some way benefited my employer, and indirectly my own bonus, I would be unable to attribute specific income to Safeway. Thus if Farmer Hanko were a city council member and the local Safeway store appeared before her council seeking a new building permit, would she have to recuse herself due to conflict of interest? Under Staff's advice, the answer would be yes. This is a significant expansion of the concept of "source of income" far beyond anything contemplated in current regulations that is inappropriate for the Commission to undertake without going through the public rulemaking process and conceivably without expanded statutory authority as granted by the State Legislature.

It would no doubt prove educational to consider several other examples of the application of the standard to which it is proposed that I be held.

For example, what if a hypothetical elected regional transit board member has a spouse who works as a product specialist for Oscar Mayer Hotdogs. Her transit board is negotiating a service extension agreement with a new baseball stadium that purchases Oscar Mayer products through a local foodservice distributor. The Oscar Mayer spouse receives an incentive bonus payment based on Oscar Mayer's annual sales of various products vs. target sales budgets within a given geographic region that includes the new baseball stadium. The Oscar Mayer spouse receives no commissions tied to specific sales transactions, but may from time-to-time show up at the baseball stadium in a nine-foot hotdog costume and pass out free samples or discount coupons to fans. The transit board spouse's

decisions could increase or decrease the number of hungry fans who can get to the baseball stadium. Under Staff's recommended ruling for me, the transit board spouse must disqualify herself from entering into any negotiations involving the new service to the baseball stadium if more than $500 of her Oscar Mayer spouse's incentive bonus income is derived from sales by Oscar Mayer to the foodservice distributor to the baseball stadium, regardless of whether or not it is practical or obvious for the Oscar Mayer spouse to know of any specific transaction between the foodservice distributor and the baseball stadium, and even though the ultimate choice between purchasing hotdogs or peanuts is left up to the individual fan.

In another example, what if a hypothetical appointed member of a statewide commission is also a coin collector and part-time dealer? On occasion, the Commissioner/collector consigns certain coins to a national dealer such as Heritage Numismatic Auctions, who in turn auctions the coins to other collectors through an online auction service such as eBay without the specific knowledge or involvement of the Commissioner. The Commissioner/collector frequently gives talks at various coin shows and conventions on his particular area of interest, early American coins, and is regarded as having increased the popularity of collecting colonial halfpennies and three-pence pieces, which have risen dramatically in value due to the newly created demand. Under Staff's proposed finding for me, if the Commissioner/collector has received more than $500 in income from the sale of his coins, he must determine who bought the coins from Heritage through eBay and if an individual who purchased more than $500 of his coins appears before the Commission, he must recuse himself in their case. In addition, if eBay itself appeared before the Commission and had generated more than $500 of income to the Commissioner through Heritage, the Commissioner would have a conflict of interest.

Unless the Commission is prepared to find that a conflict of interest exists in each of the above examples, they cannot find that I have a conflict of interest due to attribution of my incentive compensation bonus to MPHS.

Staff's discussion of the distinction between salary and bonus or commission also veers off into uncharted waters (Memo, page 7, paragraphs 2-5). Staff is indeed correct regarding the definition of salary and that attribution of salary to third- or fourth-party sources is inappropriate in this case.

However, Staff incorrectly tries to draw distinctions between "Incentive compensation or bonus" and "commission" and misapplies them to my case. First, attempting to distinguish amongst the three forms of variable compensation based on timing is incorrect. Any of the three may be a singular event, or an ongoing or cumulative event. Timing of payment in and of itself does not distinguish between incentive compensation, bonus, or commission. For example, a salesperson for Boeing or a commercial real estate broker may only close one transaction per twelve-month period and thus only receive a singular

payment of what is clearly commission income. Conversely, many partnerships in law, accounting, or venture capital pay bonuses (which are clearly not commission income) on a quarterly basis. Many manufacturing firms pay incentive bonuses (for productivity, for example) on a bi-weekly or monthly basis. Thus timing is not a relevant factor in determining the nature of the variable income, other than to note that commission income is specifically tied to specific sales transactions and that timing of the payment is triggered by the sales event.

Staff then goes on to define the example of an official working in a widget factory and determines that this bonus arrangement does not call for attribution of any sort. This is quite interesting because the bonus arrangement described for the widget company far more closely resembles my incentive compensation bonus formula than the supposed "facts" cited by Staff (Memo, page 8, paragraph 1).

Staff claims that my bonus is "directly related to the effort put forth toward particular clients, and at least in certain cases, such as the one presented here, specific amounts of incentive compensation can be traced directly to sales to or purchases made by specific clients." Upon examination of the facts, no such claim can be supported. My incentive compensation bonus is based on a complex formula that compares sales of various products across an entire region (not a sale to or purchase made by a specific client such as MPHS) with a sales forecast budget determined by my employer, and based on numerous calculations and factors in combination generates a monthly and yearly lump sum payment. This is the equivalent of the widget factory product bonus plan, which Staff agrees does not call for attribution of any sort. The bonus is based on performance versus a predefined target. While the bonus amount may certainly rise and fall if orders rise and fall (as is the case in the widget factory, which would certainly not build 100 more widgets if there were no more orders), the bonus is the same whether the purchasers are MPHS, other hospitals, private physicians, or other purchasers. I do not need to know or care who the individual purchasers are, only what the aggregate sales results are in order to earn my incentive compensation bonus.

The repeated creation by Staff of new regulation without authority, use of undefined terminology, and construction of facts to fit only the designated outcome desired by Commissioners raises the issue of the constitutionality of both Staff and Commission's actions towards me. Under both the United States Constitution and the Constitution of the State of California, I have the right to due process of law, and equal protection of the laws.

Staff's recommendation to the Commission clearly ventures into the creation of new regulations without following the due process of law. Direction by the Commission to the Staff to produce support for a predetermined outcome (as clearly shown in the Minutes of the June 7, 2002 meeting) violates my right to due process under the law. My right to equal protection of the law is also violated by the use of double standards to approve conduct by others (such as associates

in law firms) while holding that conduct (so similar as to be identical) by me constitutes a conflict of interest. In addition, the creation of new regulations and definitions to disqualify me by virtue of conflict of interest, when I came forward voluntarily to seek an advice opinion (while not proactively applying those same standards in enforcement actions against others who may be in similar situations) is a violation of my right to equal protection of the law.

It is incumbent upon the Commission to uphold both the Constitution of the State of California and the Constitution of the United States of America and treat me according to due process of law, with equal protection of the law.

III. Summary and conclusion

What began as a simple, voluntary request for clarification of the existing definition of Source of Income and Sources of Commission Income, so that an honest elected official could conduct her district's business free from fear of charges of conflict of interest, has veered off into a train wreck.

Staff's original advice letter (Coffey) mistakenly ruled that my incentive compensation bonus was commission income. Upon review in the second advice letter (Brown), and subsequently, Staff agrees that my incentive compensation bonus is not commission income. Unfortunately, at that point, rather than admit their mistake and answer my request for clarification, Staff proceeded to begin defining new terms ("like a commission") and create new regulation without following the proper public rulemaking process (Staff's own recommendation to the Commission recognizes that it would be appropriate to place the incentive compensation issue on next year's regulation calendar but asks the Commission to allow its ad hoc regulation in the form of an Advice Letter to stand until then, which is patently unfair [Memo, page 10, paragraph 2]).

Upon appeal of the advice letters to the full Commission, instead of serving as a forum to understand and interpret the existing regulations, the Commission chose instead to engage in a prosecution of me on irrelevant matters such as my salary and total income.

It would be far more appropriate for the Commissioners to look at the underlying regulation to which I am subject and decide for themselves (using the current regulation and definitions, not the newly hatched and ill-defined theories of Staff) whether or not a source of income exists which may lead to a conflict of interest. The current, existing regulations, and the thought process that I (as a reasonable and rational elected official) used to determine if a conflict existed, are described below:

18703.3. Economic Interest, Defined: Source of Income.

(a) A public official has an economic interest in any person from whom he/she has received income aggregating five hundred dollars ($500) within 12 months prior to the time when the

relevant governmental decision is made. For purposes of the Political Reform Act, a public official's income includes income which has been promised to the public official but not yet received by him or her, if he or she has a legally enforceable right to the promised income.

This paragraph clearly indicates that the only issue in determining economic interest is the receipt of more than $500 in the 12 months prior to the relevant governmental decision. The official's total income, or ratio of incentive income to salary, is irrelevant. This paragraph would seem to indicate that income which has been promised, but not yet received (as is the case with my 2002 incentive compensation bonus), should not be counted as income since there is no legally enforceable right to the promised income.

I then continued to the next potentially relevant section of the regulation:

(c) Sources of Commission Income to Brokers, Agents and Salespersons

(1) This subsection contains the disclosure and disqualification requirements for any public official who receives commission income for services rendered as an insurance broker or agent, a real estate broker or agent, a travel agent or salesperson, a stockbroker or a retail or wholesale salesperson.

18703.3(c)(1) clearly delineates certain specific occupations. It does not say "for example," or "like a. . ." or give any indication that there would be other occupations which should be covered by this regulation.

(2) "Commission income" means gross payments received as a result of services rendered as a broker, agent, or other salesperson for a specific sale or similar transaction. Commission income is received when it is paid or credited.

The definition of "commission income" is quite specific that it must result from a specific sale or similar transaction. As my incentive compensation bonus payment derives from an aggregation of multiple sales transactions vs. a sales budget, it is <u>not</u> the result of a specific sale or transaction and it cannot be considered to be "commission income," as Staff has previously agreed

Since the Staff has conceded that I do not receive "commission income," there is no basis for ruling that I must attribute income (commission, incentive compensation bonus, or otherwise) to anyone other than my employer, Baxter Healthcare Corporation.

Regulation 18703.3 is well designed and deliberately narrow in scope so as to be manageable. An effective regulation must be capable of consistent interpretation by reasonable persons, and must be capable of being applied fairly and equally across all who are subject to it.

Instead, an interpretation of dubious constitutionality, combined with a completely new concept of attribution of source of income beyond the employer has been adopted. Further, a new type of income, "incentive compensation," has been both defined and ruled to have a source other than the employer in certain circumstances, much like commission income. These two newly created

concepts will create potential conflicts of interest for an unknown number of public officials and will also discourage well-meaning citizens from taking roles of responsibility in the public sector.

In conclusion, Staff has acted unreasonably and without authority to declare that I have a source of income attributable to MPHS. Its basis for drawing this conclusion is not borne out by the facts in this case and is apparently based on newly created, vague, and ambiguous definitions designed to fit a desired outcome. Should Staff's recommendation be validated by the Commission's issuance of an opinion, I (and other public officials) would have no basis for determining what sources of income might be attributable to third- or fourth-parties without seeking advice from Staff in each instance. This results in an untenable situation for all parties.

This seems to violate the very principle of fairness embodied in the name of the FPPC itself-- Fair Political Practices Commission.

IV. My Proposal for Action by the Commission

It is respectfully requested that the Commission issue an opinion rejecting the incentive compensation analysis set forth in the Memo, setting aside both the Coffey and Brown Advice Letters, and declaring that I have no conflict of interest with respect to decisions concerning MPHS.

In the alternative, if the Commission issues an opinion supporting recommendations made by Staff in the Memo, I request that precise definitions of unacceptable relationships and actions and their limitations be provided by the Commission in sufficient detail such that I would be able to take steps to eliminate any possible attribution of income that might create a conflict of interest.

I would ask that the alternative recommended by Staff in the Memo (page 10, paragraph 2) to let the two Advice Letters stand and place the issue on next year's regulation calendar be firmly rejected because it would subject me to advice which has already been proven incorrect by Staff's own analysis in the Memo, and an unreasonable period of time would ensue before these letters would be overturned by the new regulation. In the mean time, I would continue to be left without a voice (as I have been for over a year) in important matters before my Board, disenfranchising the voters who elected me to this position. All along I have been trying to do the right thing for my community and follow all the rules you've established, but I cannot do that if you alter the rules midstream. The contract our Board reaches with MPHS/Sutter will dramatically affect healthcare in our community for the next 50 years. Please remove my handcuffs and allow me to work for the 23,500 people who elected me.