ARCHER ■ NORRIS

2033 North Main Street, Suite 800
PO Box 8035
Walnut Creek, CA 94596-3728
925.930.6600
925.930.6620 (Fax)

CALIFORNIA OFF
Walnut Cr
Richmc
Onta

COLIN J. COFF
(other inf
ccoffey@archernorris.co

March 15, 2001

BY FACSIMILE AND OVERNIGHT MAIL (916) 327-2026

Luisa Menchaca
Acting General Counsel
Fair Political Practices Commission
428 J Street, Suite 620
Sacramento, CA 95812-0807

Re: Request for Formal Advice / Peninsula Health Care District
Director Terilyn Hanko

Dear Ms. Menchaca:

I act as General Counsel to the Peninsula Health Care District, organized under the provisions of the California Health and Safety Code, Sections 32000 et seq., and submit this request on behalf of the District for formal advice pursuant to Government Code Section 83114 and Cal. Code of Regulations, Title 2, Section 18329. The District has two new Directors elected to its Board in the November election of the year 2000, Directors Terilyn Hanko and Tobin Schneider, M.D. Questions concerning the new members' potential financial conflicts of interest have arisen in connection with a pending decision before the District Board. Please note that we are submitting a separate advice letter request addressing each of the two Directors' individual circumstances for ease of reference. The governmental decision before the District in each case, however, is the same and the description of that matter herein will be duplicative.

In each case the District is seeking your advice concerning whether a financial conflict of interest exists that will prevent the Director from participating in, and voting on, the subject decision.

Ms. Hanko is a "Pharmaceutical Products Specialist" for Baxter. Her employment consists chiefly of marketing certain Baxter pharmaceutical products to healthcare providers, including many hospitals, long term care providers, surgery centers, and other health services providers. Her efforts on behalf of Baxter are focused on educating healthcare professionals in these various settings about Baxter products available to them, including product introductions and follow up utilization and general information about the use of the products. Her representation of Baxter thereby encompasses pre and post sales representation. Director Hanko is Baxter's representative for these products covering a territory extending from San Francisco, along the San Francisco/San Mateo peninsula, and south to Santa Cruz.

Ms. Hanko does not "take orders" or conduct actual sales transactions.[2] Healthcare providers purchase Baxter products (and other pharmaceutical and related products) through independent specialty wholesale companies with whom the providers conduct orders and purchase transactions. Many factors might lead to increases or decreases of sales of Baxter products within Director Hanko's coverage territory including the success and medical utilization of a product, the growth or decrease in provider services, general and healthcare economic trends, trends in the population's health, and especially changes in the overall population of the territory. Another major factor beyond an individual Baxter representative's control is the changing purchasing practices of Group Purchasing Organizations, which switch product relationships based on global price bidding. Individual providers and provider health systems often participate in such group purchasing entities.

Certainly it is intended that Director Hanko's representation of the Company will result in increased awareness and use of Baxter products by providers of health services within her coverage territory. The Company therefore provides potential bonus payments to its representatives, such as Ms. Hanko, based on overall sales of Baxter products within the representative's territory.

The Company annually establishes budgets for projected sales of product groups within a territory. It then creates a formula based on a target that is a percentage of projected total sales for a representative's product group and territory. The target (e.g., 85% of projected gross sales for the calendar year) becomes a minimum threshold of overall product sales in the territory prior to any incentive income being paid. If during the year the overall sales of the product group exceed the targeted percentage of projected sales, the representative may receive incentive compensation that increases with the amount overall sales exceed the minimum threshold target of gross sales.[3] It is important to note that the budget and target sales formulas do not take into

[2] See footnote 1 above.

[3] During the course of a calendar year advances on annual earned incentive payments will be made to Company representatives based on year to date sales versus projections. These advances are ultimately reconciled on an annual basis based on actual sales for the year, with the employee possibly owed more incentive compensation, or in a position to pay back some advance payments if actual year end sales do not meet the pre-established payment criteria.

consideration any individual efforts by Director Hanko as a Baxter representative. The Company does not, and cannot, trace individual product sales to its representatives. So the budget and target sales formulas are based entirely on product gross sales performance.

Two more aspects of this extra compensation arrangement seem to indicate the characteristics of an employer discretionary bonus payment rather than a specific sales commission. The Company reserves the ability to change its projected sales budgets and threshold sales targets during the course of a year (and in practice occasionally does change the target) based on its own evaluation of the Company's health and changing market conditions. Within the same context, the Company reserves the right to cancel, at any time, the incentive compensation program altogether, and employee representatives must acknowledge in writing that the incentive program creates no express or implied contractual right to extra compensation.

Baxter employs consultants that conduct regular surveys of Baxter product sales through the independent wholesalers that conduct actual orders and sales with providers, such as hospitals. Baxter can determine from these consultants the approximate gross sales of its products to individual purchasers.[4] These estimates are approximate because of the method of data collection employed by the sales survey consultants. It is nevertheless possible to determine the approximate percentage of overall product sales in a given territory that are attributable to sales to a specific provider. In this manner Director Hanko can estimate the percentage of overall Baxter sales in her coverage territory attributable to MPHS purchases at Peninsula and Mills hospitals. Based on the year 2000 incentive compensation she received, Director Hanko can estimate what percentage of that extra compensation in turn can be attributed to MPHS Baxter purchases. Her estimate is approximately $1000 of her total incentive compensation from Baxter could be in this manner attributed to MPHS purchases of Baxter products in 2000. It is likely (she has not made this calculation) that a somewhat larger amount of her year 2000 incentive compensation could be attributed to purchases of Baxter products by other Sutter affiliated facilities in her coverage territory.

Source of Income Issue

Section 18703.3 (c)(3)(F)(ii) of the Commission's Regulations define a "source of commission income" for disqualification purposes to include the person who purchases a product from a retail or wholesale salesperson. The key interpretive questions are (1) whether Director Hanko receives "commission income" as defined in the regulation and,

[4] The purchasers certainly know what products they are buying and of course can identify how much they are spending on a given company's products. MPHS identified for us the expenditures referred to above that were made in year 2000 on Baxter products. Baxter does not have access to such exact figures. There are also Baxter direct sales to providers conducted by divisions of the Company not connected to Director Hanko and not considered in her incentive compensation program.

(2) whether the person who "purchases the product" (and is thereby possibly a source of income) includes the ultimate purchaser who buys through a third party wholesaler. The Regulation is designed to attribute commission income directly to the buyer so as to render the buyer, not just the employer, a source of income for purposes of potential disqualification of an official employed as a salesperson. Hence the issue becomes whether MPHS is considered a direct source of income creating a disqualifying economic interest for Director Hanko in the Hospital itself.

As indicated above, it appears Section 18703.3 (c)(3)(F) is intended to apply to a direct purchaser of a single identifiable product and to a transaction in which the salesperson is directly responsible for the sale and earns a contractually fixed share, or "commission," on the single transaction. In Director Hanko's situation, her "bonus" is based on gross regional sales conducted through wholesalers, cannot be traced to individual items sold, is not triggered unless gross sales to all her employer's end use customers reach a certain level, is not based on her individual efforts, and is not fixed nor even guaranteed. It therefore appears that this aspect of income from her employer is in the nature of a discretionary bonus based on the health of the Company and its overall sales performance in a given territory, as opposed to "commission income" within the meaning of Section 18703.3 (c)(3)(F).

Please let me know if I can supply any additional information that will assist your review of these facts and questions. Your advice will be greatly appreciated by the District and its Directors. Director Hanko's mailing address is set forth below.

Very truly yours,

Colin J. Coffey
General Counsel
Peninsula Health Care District

Terilyn Hanko
Director, Peninsula Health Care District
P.O. Box 1964
Burlingame, CA 94010