



FAIR POLITICAL PRACTICES COMMISSION

February 13, 1998

Craig J. Cannizzo
Hanson, Bridgett, Marcus, Vlahos & Rudy, LLP
333 Market Street, Suite 2300
San Francisco, California 94105-2173

**Re: Your Request for Advice
Our File No. A-97-562(a)**

Dear Mr. Cannizzo:

This letter is in response to your request for advice regarding the conflict-of-interest provisions of the Political Reform Act (the "Act").¹

In the *Cannizzo* Advice Letter, No. A-97-562, we advised that a nonprofit corporation ("NewCo") formed by the Eden Township Hospital District ("Eden") and Sutter Health ("Sutter") was a "local government agency" under the Act. You are requesting reconsideration of our advice based upon facts that were omitted from your original request.

QUESTION

Do the additional facts in your request for reconsideration alter our previous advice to you which concluded that NewCo is a "local government agency" under the Act?

CONCLUSION

Yes, after considering the additional facts, we conclude that NewCo is not a governmental agency. Although, the first and fourth criteria of the *Siegel* test are met to some extent, these factors alone, under your facts, do not lead to the result reached in the first letter.

¹ Government Code sections 81000 - 91014. Commission regulations appear at title 2, sections 18109 - 18995, of the California Code of Regulations.

FACTS

Eden is a local health care district, organized and operated under the Health and Safety Code.² (Health & Saf. Code §§ 32000 et seq.) Eden owns and operates acute care health facilities known as Eden Medical Center and Laurel Grove Hospital in Castro Valley. The district encompasses the geographic area generally including the cities known as Hayward and San Leandro and the unincorporated areas known as Castro Valley and San Lorenzo.

On December 18, 1996, after a five-month public review process which involved competitive proposals from five health care systems, Eden's board of directors elected to affiliate with Sutter, a California nonprofit corporation based in Sacramento. Under the affiliation, Eden will transfer its health facilities to an existing nonprofit corporation, NewCo. NewCo is a wholly owned subsidiary of Sutter and was originally formed by the Children's Hospital of San Francisco in 1984. On January 22, 1997, the board adopted Resolution No. 358 calling a special election within the district to approve the transfer of assets and liabilities to NewCo. (Health & Saf. Code § 32121.) On April 22, 1997, a special mail ballot election was held which approved the transaction.

Pursuant to the memorandum of understanding between Eden, NewCo and Sutter, Eden will transfer its health facility assets and other designated assets to NewCo. Currently, Sutter is its sole corporate member. As part of the transaction, NewCo will be reorganized to have two corporate members, Eden and Sutter. As the two members of NewCo, Eden and Sutter reserve certain powers with respect to major decisions which might affect NewCo. The governing board of NewCo will consist of 11 directors: five directors will be members of the Eden Board of Directors; Sutter will appoint five directors (with the initial approval of Eden), and the CEO of NewCo will be a director. Eden will appoint the initial CEO and subsequent CEOs will be nominated by Eden and jointly approved by Eden and Sutter.

Eden's assets will be transferred to NewCo in exchange for fair market value. Pursuant to the memorandum of understanding, Sutter will retire outstanding bonds issued by Eden in the amount of \$40,000. Sutter will also transfer \$30 million to Eden at closing and pay Eden an additional \$10 million out of the earnings of NewCo (an "earnout"). Sutter/NewCo will assume substantially all of Eden's liabilities, including workers' compensation liability in the amount of \$2 million. In addition, Sutter will make a working capital contribution of \$1 million to NewCo. In summary, the total consideration to be received by Eden is valued at \$69 million. This figure is substantially equal to or greater than the fair market value of the transferred assets based upon a "fairness opinion" obtained from Eden's investment bankers. Eden will also retain cash reserves previously earned in the amount of \$55 million. This sum will be augmented by the \$30 million cash payment and the additional earnout payments.

² This recital of facts are the original facts set forth in the *Cannizzo* Advice Letter, No. A-97-562. The additional facts you have provided are discussed in the analysis.

Once operating, NewCo is expected to operate as a self-supporting enterprise. It will not receive tax revenues or public funds from the district on an ongoing basis. The primary source of funds for NewCo will be revenues generated from the operations of the acute care facilities. In addition, NewCo will have access to borrowing additional capital from future Sutter-wide system financings as needed by NewCo on the same terms and conditions as other health facilities affiliated with Sutter. To accomplish this financing arrangement, NewCo will become a member of the Sutter "Obligated Group" under the terms and subject to the conditions of the Sutter Master Trust Indenture. Eden, however, will not become a member of the Sutter Obligated Group.

NewCo will be jointly and severally liable for the pre-existing and future indebtedness of Sutter and other Sutter affiliates that are members of the Obligated Group. In turn, Sutter and Sutter affiliates will be jointly and severally responsible for NewCo's future indebtedness incurred during the Master Indenture. Additionally, NewCo is obligated to adopt and implement Sutter's "Treasury Policies." The "Treasury Policies" consolidate cash management and investment policies for NewCo with the cash management and investment policies of Sutter. The consolidated funds are managed and invested by Sutter in accordance with the Treasury Policies. In addition, under the "Excess Cash Transfer Policy," which is a part of the Treasury Policies, excess cash revenues earned by NewCo above a "target" (the "target" being 14 days of budgeted operating expenses, excluding depreciation) are transferred to Sutter, and Sutter may use such transferred revenues for the benefit of the Sutter system as a whole or other Sutter affiliates.

NewCo's board of directors will have responsibility for operational decisions regarding the management and direction of NewCo, such as staffing, contracting with medical groups, insurers and other decisions relating to hospital operations. The NewCo members, Sutter and Eden, will retain authority over larger issues of the corporation, such as choosing directors, amending articles of incorporation or bylaws, and dissolution.

NewCo is sensitive to the fact that the five Eden district board members serving on the NewCo Board of Directors will constitute a quorum of Eden's governing body. Thus, meetings of the NewCo board of directors will be conducted in a manner that is consistent with the open meeting requirements of the Brown Act.

ANALYSIS

Section 87300 of the Act requires every agency to adopt and promulgate a conflict of interest code. The term "agency" includes "any local government agency." (Section 82003.) A "local government agency" is defined as "a county, city or district of any kind including school district, or any other local or regional political subdivision, or any department, division, bureau, office, board, commission or other agency of the foregoing." (Section 82041.)

In a formal opinion, the Commission developed an analytical framework to determine whether seemingly private entities are public agencies under the Act. (*In re Siegel* (1977) 3

FPPC Ops.) In the *Siegel* opinion, the Commission held that a nonprofit corporation formed for the purpose of acquiring and operating a water system was a public agency under the Act. On its face, the nonprofit corporation appeared to be a private entity. To determine the true nature of the entity for purposes of the Act, the Commission developed four criteria.

In our original advice to you, we applied the *Siegel* test and concluded that NewCo was a governmental agency because it met two out of four factors. (See *Guiffre* Advice Letter, No. A-89-066 [advising that the *Siegel* opinion does not require that all four criteria be met].) We advised that the second and third criteria were not met. You would like us to reconsider our advice regarding the first and fourth factors.

First Criterion

The first *Siegel* factor is whether the impetus for formation of the entity originated with a governmental agency. In the previous letter we advised that the first criterion was met because the impetus to affiliate originated with Eden and the affiliation involved the reorganization of NewCo. (See *Miller* Advice Letter, No. 82-016 [advising that the restructuring of an entity at the impetus of a governmental agency was sufficient to establish that the first *Siegel* factor was met].)

1. New Facts

While Eden did initially send out a request for proposals to affiliate with a larger health care system, it did not have any particular type of affiliation in mind. The request for proposals drew a number of different responses, including for-profit and nonprofit arrangements, as well as straight buyout of Eden's hospital assets. Sutter proposed that the affiliation be implemented through a private nonprofit subsidiary corporation, NewCo. Eden's representatives initially advocated for a joint venture arrangement; however, in the course of negotiation, Eden agreed to Sutter's proposed use of NewCo.

2. Analysis

Generally, the first factor is met where an entity is created by statute or ordinance, or by some official action of a governmental agency. However, we have previously advised that, in certain circumstances, if an entity is not created by a statute or ordinance, the fact that it meets the first factor may be less significant. For example, in the *Sheeks* Advice Letter, No. A-90-026, we advised that an entity created by hospital districts throughout the state to act as a trade association met the first criteria, but that meeting the first criteria, in that context, was less significant because the entity was not created by statute or ordinance. In the *Moser* Advice Letter, No. A-97-400, we reached a similar result. In that letter, a private university and a public university created an entity to use as a vehicle to integrate its health care delivery systems. We advised that the first factor did not apply because the entity was not created as a division or department of the public university.

In this case, NewCo was not created by a statute or ordinance, nor was it created as a division or department of Eden. In addition, the idea of using NewCo as a vehicle for the affiliation originated with Sutter and not Eden. Under these facts, we conclude that, although the first factor is met (since NewCo would not have been created without Eden's participation), the fact that NewCo meets the first factor is not dispositive in this context.

Fourth Criterion

The fourth criterion is whether the entity is treated as public by other statutory provisions. We advised that the fourth *Siegel* factor was met because meetings of the NewCo board of directors will be conducted in a manner consistent with the open meeting requirements of the Brown Act. (See *Neufeld* Advice Letter, No. A-96-258, *Harmon* Advice Letter, No. I-92-084, *Francis* Advice Letter, No. A-86-214, *Gill* Advice Letter, No. A-85-167 [advising that entities subject to the Brown Act meet the fourth *Siegel* criterion].)

1. New Facts

You believe the Brown Act is inapplicable to NewCo, even though the NewCo board of directors, as a matter of policy, has elected to hold public meetings. Moreover, in a validation judgment, pursuant to Civil Code section 860, a trial court held that NewCo could validly make financing commitments described in the Memorandum of Understanding--commitments that Eden as a public entity would be barred by statute from making due to financing restrictions contained within the Local Health Care District Law codified at Health and Safety Code sections 32000 et seq. (*Eden Township Hospital Dist. v. All Persons Interested in this Matter* (Sup. Ct. Alameda County, 1997, No. H197243-0).)

You also believe NewCo is not subject to the following statutory provisions:

1) Government Code sections 53600 and 53601.1, which place restrictions on the manner in which local agencies invest surplus funds; 2) the California Tort Claims Act (Cal. Gov. Code §§ 811.2, 815), which provides immunity to public entities from civil liability; 3) the Public Records Act (Cal. Gov. Code §§ 6250 et seq.), which provides public access to specified government documents; 4) the California Public Employees' Retirement System, (Cal. Gov. Code §§ 20056-20057), which provides a retirement system for governmental employees; and 5) Health and Safety Code section 1254, which exempts government operated hospitals from certain licensing requirements. Finally, the bonds issued by NewCo will be private bonds and not government bonds which are the obligation of a state or political subdivision.

2. Analysis

In a previous letter, we advised that the fourth factor was met where the bylaws of a proposed corporation subjected the entity to the Brown Act. (*Alperin* Advice Letter, No. A-95-118, see also *O'Shea* Advice Letter, No. A-91-570.) In this case, the NewCo board of directors has elected to hold meetings in accordance with the Brown Act. Therefore, we think this factor has been met. However, we have also advised that this factor alone is not determinative. (*Epp*

Advice Letter, No. A-92-195.) Moreover, we have advised that meeting this factor is less significant where other statutory provisions applicable to public agencies treat the entity as a private entity. (*Stone* Advice Letter, No. A-97-630.) You have indicated that NewCo is treated as a private entity in numerous other contexts; therefore, if your analysis is correct, we do not view this factor as significant to our analysis.

In reassessing the factors set forth in the *Siegel* opinion, we conclude that NewCo is not a governmental agency. Although, the first and fourth factors are met to some extent, these factors are not determinative as applied to your facts. In addition, we previously advised that the second and third factors were not met.

Conflict of Interest Law, Generally

Section 87100 prohibits public officials from making, participating in making or using their official position to influence a governmental decision in which they know or have reason to know they have a financial interest. The members of the Eden board of directors are considered "public officials" under the Act. (Section 82048.)

Since NewCo is not considered a "local government agency," its decisions are not governmental decisions within the meaning of the Act, which would otherwise have the potential of subjecting the members of the Eden board of directors to disqualification in their capacity as members of the NewCo board of directors. However, if a NewCo decision is submitted to the health care district for consideration for approval or other action, that decision would fall within the Act's purview. (*Prestidge* Advice Letter, No. A-95-323.)

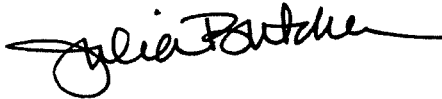
For purposes of section 87100, a public official "makes a governmental decision" when the official votes on a matter, commits the agency to a course of action, or enters into any contractual arrangement on behalf of the agency. (Regulation 18700(b).) Regulation 18700(c) provides that a public official "participates in making a governmental decision" when, acting with the authority of his or her position, the official negotiates, without significant substantive review, with a governmental entity or private person regarding the governmental decision or advises or makes recommendations to the decisionmaker, either directly or indirectly, without significant intervening substantive review.

A public official uses his or her position to "influence a governmental decision" if the official contacts, or appears before, any member, officer, employee of the official's agency or any agency under the appointive or budgetary control of the official's agency. (Regulation 18700.1(a).) In addition, a public official attempts to influence a decision if the official acts or purports to act on behalf of, or as the representative of, his or her own agency to any member, officer, employee or consultant of any other local or state governmental agency. (Regulation 18700.1(c).)

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

Sincerely,

Steven G. Churchwell
General Counsel

A handwritten signature in black ink, appearing to read "Julia Butcher", with a stylized flourish at the end.

By: Julia Butcher
Staff Counsel, Legal Division

SGC:JB:tls