



## FAIR POLITICAL PRACTICES COMMISSION

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March 20, 2001

Paul J. Dostart  
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**Re: Your Request for Advice  
Our File No. A-00-022**

Dear Mr. Dostart:

This letter is in response to your request for advice on behalf of the San Diego Workforce Partnership, Inc. regarding the conflict-of-interest provisions of the Political Reform Act (the "Act").<sup>1</sup>

### QUESTIONS

1. Following the bylaw amendments, does the partnership qualify as a "local government agency" for purposes of the Act?
2. Are the partnership's non-governmental directors "public officials" within the meaning of the Act?
3. Following the bylaw amendments, are the non-governmental directors required to comply with the conflict-of-interest provisions of the Act?
4. If the partnership forms a for-profit entity in order to commercialize software or other products which arise from the partnership's operations, will the board of directors of the for-profit entity be subject to the reporting requirements of the Act if the partnership owns more than 50 percent of the outstanding stock of the for-profit entity?

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<sup>1</sup> Government Code sections 81000 - 91014. Commission regulations appear at Title 2, sections 18109 - 18996, of the California Code of Regulations.

5. Does the answer to question 4 change if the partnership owns either exactly 50 percent or less than 50 percent of the outstanding stock of the for-profit entity?

### CONCLUSIONS

- 1-3. The partnership is a local government agency and its members are subject to the conflict-of-interest disclosure and disqualification provisions of the Act. The amendment to the by-laws does not affect this conclusion.
- 4-5. We do not have sufficient information about the proposed corporation to reach a conclusion.

### FACTS

#### **Background**

The San Diego Workforce Partnership, Inc. (the "partnership") is a California nonprofit public benefit corporation that was incorporated for public and charitable purposes. Specifically, the partnership was formed to develop and to administer programs in furtherance of the Federal Government's Job Training Partnership Act. In 1998, Congress enacted the federal Workforce Investment Act ("WIA"). The WIA repealed the Job Training Partnership Act and took effect on July 1, 2000. Under the WIA, the Governor must designate local workforce investment areas. In each workforce investment area, the state will establish both state and local workforce investment boards ("WIBs"). The state WIB will help the Governor develop a five-year strategic plan. Local WIBs, in partnership with local elected officials, will plan and oversee the local job training system. In addition, local WIBs will designate local program operators, identify eligible providers of training services, monitor system performance, negotiate local performance measures, and develop an employment statistics program.

A Joint Powers Agreement was adopted in March 1974, and most recently amended on June 24, 1997, by both the City and County of San Diego. The Joint Powers Agreement was adopted in order to provide regional employment and training services. The agreement created a regional consortium (the "consortium") to provide and coordinate job training and employment services on a regional basis. The governing body of the consortium is a five-member board, titled the "Policy Board." The Policy Board consists of two members each from the San Diego County Board of Supervisors and the San Diego City Council. The fifth member is a member of the San Diego Chapter of the United Way.

The Policy Board of the consortium has authority over the Private Industry Council (the "PIC") whose members are primarily from the private sector. The PIC is an entity separate and distinct from both the City and County of San Diego. The consortium and the PIC are essentially conduit organizations through which both the City and County of San Diego channel federal funds from the Job Training Partnership Act to the partnership. Both the Consortium Policy

Board and the PIC are subject to the open meeting laws of the Brown Act. The Brown Act also applies to committees of the PIC and the Policy Board.

### **Change in Organizational Structure**

Prior to a recent change in the partnership's bylaws, the partnership's board consisted of nine voting board members, two of whom also sat on the consortium's Policy Board. Those Policy Board directors included one member from the San Diego City Council and one member from the San Diego County Board of Supervisors. All nine directors were voting directors.

The partnership believed it was subject to the conflict-of-interest provisions of the Political Reform Act. As such, its bylaws incorporate by reference the conflict-of-interest provisions provided at Section 18730 of the regulations of the Fair Political Practices Commission. Those provisions require all members of an entity's board of directors, including those members who do not also sit on a government body similar to the city council or county board of supervisors ("non-governmental directors"), to comply with its terms.

Recently, the partnership's bylaws were amended. The amendments expanded the partnership's board from nine directors to between eleven and seventeen directors. Additionally, the amendments changed the voting status of the partnership's two Policy Board directors to non-voting. As a result, all the voting directors of the partnership are non-governmental directors. The partnership's non-Policy Board directors are no longer appointed by any legislative body or governmental entity; rather, the non-Policy Board directors now appoint their own successors. Legislative bodies appoint only the two non-voting Policy Board directors.

The partnership's board of directors now consists of one member of the San Diego County Board of Supervisors and one member of the San Diego City Council (both of whom are non-voting members), and up to fifteen other members, none of whom are governmental officials.

### **Development of Proprietary Software**

The partnership is currently developing unique software that will control a database relating to job classification, training, employability and similar factors. To date, this software has been developed with non-governmental funds, although some governmental funds may be used in the future.

The partnership has become aware that there are approximately 600 other entities in the United States which, like the partnership, would find the software advantageous in promoting efficiency in their respective operations. Moreover, the database can be used in a manner advantageous to for-profit companies without infringing upon the privacy rights of job seekers. For example, employers seeking workers with specific skills would likely be very eager to subscribe to services providing automatic e-mail notification of the registration of individuals

having the requested specific skills. The software will need to be routinely updated to keep it current as computer technology advances.

Accordingly, the partnership is evaluating the establishment of what will initially be a wholly owned for-profit entity to continue the development of the software. Because the software development costs might exceed \$1 million, the partnership board of directors believes it may be prudent to seek outside capital investment to provide the funds necessary for the development, marketing and maintenance of the software. Presumably this will be accomplished by the for-profit subsidiary's preparation of a private placement memorandum and the raising of large sums of outside investment capital through a stock issuance. A stock issuance would dilute the partnership's ownership of the software (or of the for-profit entity to which the partnership transfers the software) from its current 100 percent to a number which may be greater or less than 50 percent. The stock held by the partnership would, however, continue to be an asset held by a nonprofit public benefit corporation. Should the partnership sell its stock, all of the proceeds of such a sale would be used for the partnership's charitable or public purposes.

The partnership is concerned about the potential consequences of this opportunity. For example, in a typical round of venture capital financing, some of the venture capital investors will request representation on the board of directors of the investee as a condition to making the investment. If the partnership's wholly owned subsidiary were to raise \$2 million in a private stock offering which diluted the partnership's holdings to, say, 55 percent of the outstanding stock of the subsidiary, it would be important to disclose to the directors selected by the venture capital investors whether they will be subject to the reporting provisions of the Act. If venture capital investors invest in the for-profit subsidiary of the partnership in exchange for shares issued by the subsidiary, it is probable that an investor will adversely view the requirement that he/she become subject to the reporting requirements of the Act.

## ANALYSIS

### Local Government Agencies

Section 82003 defines "agency" to include "any state or local government agency." Section 82041 defines "local government agency" to mean "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."

In 1977, the Commission considered the definition of "local government agency" in *In re Siegel* (3 FPPC Ops. 62, copy enclosed). The *Siegel* Opinion involved a nonprofit water development corporation formed by the City of Pico Rivera. The Commission applied the following four-part test:

1. Whether the impetus for formation of the entity originated with a government agency.

2. Whether the entity is substantially funded by, or its primary source of funds is, a government agency.

3. Whether one of the principal purposes for which it is formed is to provide services or undertake obligations which public agencies are legally authorized to perform and which, in fact, they traditionally have performed; and

4. Whether the entity is treated as a public entity by other statutory provisions.

In *Siegel*, the Commission concluded that the corporation was a local government agency and the members of the corporation's board of directors were subject to the disclosure and disqualification requirements of the Act. While the *Siegel* factors were not intended to be a definitive litmus test for determining whether an entity is public for purposes of the Act, by applying the factors to the set of facts presented in your letter, we can draw some conclusions with respect to the status of the partnership. Ultimately, however, the test must still be a factual analysis on a case-by-case basis. (*In re Vonk* (1981) 6 FPPC Ops. 1, copy enclosed.)

The first factor is whether the impetus for formation of the partnership originated with a governmental agency. Generally, the first factor has been met where an entity is created by statute or ordinance, or by some official action of another local government agency. For example, in the *Siegel* opinion, although the agency was created as a nonprofit corporation, the city council was intimately involved in the creation of the corporation in question. Conversely, in 1978 in *In re Leach* (4 FPPC Ops. 48), the Commission found that since the local chamber of commerce and business association preexisted the contractual relationship with the city, it was clear that the city was not the impetus for formation of the association and the chamber.

According to your facts, the impetus for formation originated with the San Diego Consortium and the San Diego Private Industry Council (PIC). PICs are local government agencies. (See, Memorandum to Private Industry Councils from the Legal Division of the Fair Political Practices Commission, April 22, 1986; see also 65 Ops. Cal. Atty. Gen. 41 (1982) advising that the members of the public industry councils created under the federal Comprehensive Employment and Training Act were "public officials" for purposes of the Act). In addition, local WIBs are created under a federal law, rather than a state or local law, but the federal law is not self-executing. To receive funding, each state must establish the governing structure that will carry out the federal law. Specifically, the Governor will designate the areas that local WIBs will serve, and local elected officials will appoint the members who will sit on the local WIBs. Since local elected officials will be integrally involved in the formation of the local WIBs, these entities meet the first factor.

Second, WIBs will receive all of their funding from federal grants. We have previously advised that if an entity receives most of its funding from federal monies, it meets the second factor. (*Prestidge* Advice Letter, No. A-95-323.) Therefore, local WIBs meet the second factor.

Third, the purpose of a local WIB is to develop and oversee job-training programs at the local level. Of course, job training is a service offered by both private and public agencies. Nevertheless, the federal government authorized the formation of local WIBs to do more than just provide job training. Local WIBs are part of a national program designed to “improve the quality of the workforce, reduce welfare dependency, and enhance the productivity and competitiveness of the Nation.” These are obligations that public agencies have traditionally performed.

The Internal Revenue Service tax ruling you provided with your request (dated March 1, 2000) supports our conclusion. The ruling concludes that the partnership is a wholly-owned instrumentality of the city and county and that it was formed to fulfill a governmental purpose. As such, local WIBs meet the third factor.

Fourth, the WIA treats local WIBs as government agencies. Local elected officials appoint the members of local WIBs. The Governor must certify local WIBs every two years. Local WIBs must work with local elected officials to develop local plans, which they then submit to the Governor. A local WIB’s budget is subject to approval by local elected officials. In summary, local WIBs carry out their statutory functions in partnership with, or subject to approval by, government agencies. Thus, local WIBs meet the fourth *Siegel* factor.

Accordingly, the Work Investment Board of San Diego meets all of the criteria of a local governmental agency under the *Siegel* test, and therefore must adopt a conflict of interest code. In addition, as public officials (Section 82048), all of the members of the WIB are subject to the Act’s conflict-of-interest rules since they make or participate in the making of governmental decisions. (Section 87100; *Baird* Advice Letter, No. A-94-299.)

### **Private Corporation for Software Development**

We apply the same analysis to the corporation the partnership wishes to create.

- First, the impetus for formation of the new corporation originated with the partnership, which we have just concluded is a local government agency. Since a local elected officials will create the corporation, the corporation meets the first factor.
- Second, the corporation will receive the majority of their funding from the partnership. This may change if private investors are brought in to fund the corporation; however, it does not appear that the public monies will ever be less than substantial.
- As to the third factor, this is not met with respect to the corporation. Software development is not a function that public agencies have traditionally performed.

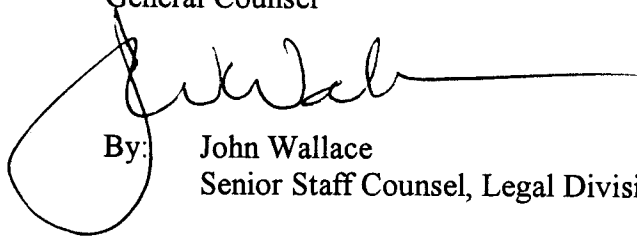
- With respect to the last factor, we do not have sufficient information to conclude whether other laws treat the corporation as a government agency.

Consequently, two of the four factors are met, one factor is not, and it is unclear whether the last one is. Without additional facts, we cannot conclude whether the corporation will be a local government agency under the Act.

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

Sincerely,

Luisa Menchaca  
General Counsel

A handwritten signature in black ink, appearing to read "John Wallace", is written over a large, loopy scribble that partially obscures the text below it.

By: John Wallace  
Senior Staff Counsel, Legal Division

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