

MEMORANDUM OF LAW

DATE: June 5, 1989

TO: Mayor Maureen O'Connor and Councilmembers
Wolfsheimer and Henderson
FROM: City Attorney
SUBJECT: Potential Conflict of Interest Arising from
Council Discussion Regarding Proposed SDDPC
Telecommunications Contract

Questions have arisen about potential financial conflicts of interest of the Mayor and two Councilmembers regarding a proposed telecommunications contract between the San Diego Data Processing Corporation (SDDPC) and a third party. The matter was discussed at the Council meetings of May 16 and 30, 1989. Subsequent to their vote on May 30, 1989 an article appeared in the LA Times on May 31 (copy attached). The Mayor and both Councilmembers have now requested a City Attorney review and response on whether they should abstain from voting.

BACKGROUND FACTS

I. Telecommunications Contract.

By amendment in 1986 of the operating agreement between the City of San Diego (City) and San Diego Data Processing Corporation (SDDPC), the City transferred to SDDPC the entire responsibility for obtaining telecommunication services for the City. SDDPC was formed as a separate non-profit corporation under California law to provide data processing (and now telecommunication) services to the City. SDDPC has its own Board of Directors that controls all affairs of the Corporation. The City is the sole member of the Corporation and its Board is appointed by The City Council. It has the capacity to enter contracts without Council approval.

Since the 1986 Amendment to the Operating Agreement, SDDPC has initiated an RFP and bidding process for telecommunication services (telephone vendor) to the City and Convention Center.

According to information supplied by telephone on May 31 by Bruce Gorton of SDDPC, seven (7) companies submitted bids on the telephone vendor RFP: 1. ATT; 2. Bell South; 3. GE/RCA; 4. GTE/GTEL; 5. NEC; 6. Pacific Bell; and, 7. Siemens/Tel Plus. Three (3) of the seven bidders bid NEC equipment (Bell South, Siemens/Tel Plus, and of course NEC). Prior to May 16, 1989, SDDPC had selected Siemens/Tel Plus with whom to negotiate the telephone vendor contract for both the City and Convention Center. The names of all bidders and rankings were provided to

the Mayor and Council by Memorandum May 10, 1989, by SDDPC Executive Vice President Robert Metzger.

II. Economic Interests.

The respective Statements of Economic Interests (hereinafter S.E.I.) show the following:

1. On her S.E.I. filed April 3, 1989, covering calendar year 1988, Mayor O'Connor lists the following investments and sources of income.
 - a. Over \$100,000 of General Electric Corporation bonds, owned by the Robert O. Peterson trust, disposed of October 21, 1988.
 - b. \$10,000-100,000 of NEC Corporation stock owned by Robert O. Peterson trust, acquired on July 25, 1988 and disposed of October 13, 1988.
 - c. Over \$100,000 of General Electric Capital bonds, owned by Robert O. Peterson trust, acquired on October 21, 1988.
 - d. Over \$10,000 income from interest and sale of General Electric Corporation bonds.
 - e. Over \$10,000 income from dividends and sale of stock of NEC Corporation.
2. On his S.E.I. filed April 3, 1989, covering calendar year 1988, Councilmember Henderson lists the following investments and sources of income:
 - a. \$10,000-100,000 of GTE Corporation stock (less than 10% interest).
 - b. \$250-1,000 income from dividends from GTE Corp. stock.
3. On her S.E.I. filed March 31, 1989, covering calendar year 1988, Councilmember Wolfsheimer lists the following investment interest:
 - a. \$26,700 of GTE Corporation stock.

According to the newspaper article, General Electric Corporation is a parent company of one of the bidders, GE/RCA. However, the City's Investment Officer, Raymond Day, clarified that General Electric Company merged with RCA recently. General Electric/RCA owns General Electric Finance Company, which in turn owns General Electric Capital Corporation. Thus, General Electric Capital is a subsidiary of one bidder, GE/RCA. Contrary to the assertion in the newspaper article, NEC is not a parent company of another bidder; it is a bidder in its own right.

The Clerk's records show that neither the Mayor nor Councilmember Henderson were present at the Council meeting on May 16; Councilmember Wolfsheimer was. All three (3) were

present, participated and voted at the meeting on May 30.

QUESTION PRESENTED:

Do the Mayor or the two Councilmembers mentioned above have a financial conflict of interest which disqualifies them from participation in any decision regarding the proposed SDDPC contract for telecommunication services to the City?

ANALYSIS

The fundamental rule regarding disqualifying Conflicts of Interest in the Political Reform Act of 1974 (the "Act") is found in Government Code section 87100 which reads as follows:

87100. Public Officials: State and Local.

No public official at any level of state or local government shall make, participate in making or in any way attempt to use his official position to influence a governmental decision in which he knows or has reason to know he has a financial interest.

I. Do the Mayor and Councilmembers have a "financial interest" within the meaning of the Act?

To reach a conclusion under Government Code section 87100, the first issue to be determined is whether a public official has a "financial interest" within the meaning of the Act.

The term "financial interest" for purposes of section 87100 is defined in relevant part in Government Code section 87103, as follows:

87103. Financial Interest.

An official has a financial interest in a decision within the meaning of section 87100 if it is reasonably foreseeable that the decision will have a material financial effect, distinguishable from its effect on the public generally, on the official or a member of his or her immediate family or on:

a. Any business entity in which the public official has a direct or indirect investment worth one thousand dollars (\$1,000) or more.

...

c. Any source of income, other than gifts and other than loans by a commercial lending institution in the regular course of business on terms available to the public without regard to official status, aggregating two hundred fifty dollars (\$250) or more in value provided to, received by or promised to

the public official within 12 months prior to the time when the decision is made.

...

For purposes of this section, indirect investment or interest means any investment or interest owned by the spouse or dependent child of a public official, by an agent on behalf of a public official, or by a business entity or trust in which the official, the official's agent, spouse, and dependent children own directly, indirectly, or beneficially a 10 percent interest or greater.

A. Meaning of "Investment".

The term "investment" under the Act includes common stock and debt instruments (bonds) owned directly or indirectly by the public official. Note that under section 87103, indirect investments include interests owned by a spouse or by a trust in which the official owns a 10% or greater interest.

B. Meaning of "Income".

The term "income" under the Act includes payments from dividends, interest, proceeds of any sale (including sales of stocks and bonds) and includes community property interest in the income of a spouse. It also includes a pro rata share of income of a trust in which the official or official's spouse owns directly, indirectly or beneficially a 10 percent interest or greater. Income specifically does not include "dividends, interest, or any other return on a security registered with the Securities and Exchange Commission of the United States government," except it includes "proceeds from the sale of securities". Government Code section 82030(b)(5).

C. Do Mayor or Councilmembers have "Income" Interests?

Assuming GTE Corporation's stock is registered with the SEC, neither Councilmember Henderson nor Wolfsheimer has a prohibited income interest in GTE Corporation under the definition of income by virtue of any dividends they received. Government Code section 82030(b)(5).

Different issues arise with respect to the Mayor's interests. First, she has declared having received income from dividends and sales of NEC stock and General Electric bonds held by the Robert O. Peterson Trust. Therefore, we must assume that she has a 10% or greater interest in the trust. (See definition of "income" quoted above.) Also, her pro rata share of dividends or bond interest received by the trust must be claimed as income to her under the general rule. However, if the securities are listed with the SEC, dividend or interest income does not have to be

counted as "income". Government Code section 82030(b)(5). The City's Investment Officer, Raymond Day, informed me that GE/RCA's securities are listed with the SEC, but NEC's are not.

Therefore, NEC dividends, if any, would count as income to the Mayor, but General Electric Corporation bond interest would not.

The Mayor's S.E.I. is not clear as to how much she received in income from dividends and interest from NEC and GE respectively, as opposed to how much she (or the trust) received from the sale of NEC stock and General Electric Corporation bonds. In any event, if the trust or she received any gain from

the proceeds of the sales, that gain would count as income to her. For purposes of counting income from sales of securities, it is irrelevant whether they are registered with the SEC.

Government Code section 82030(b)(5).

D. Do Mayor or Councilmembers have "Investment" Interests?

Assuming they continue to hold the GTE stock, it is clear that both Councilmembers Henderson and Wolfsheimer have "investment" interests in GTE Corp within the meaning of the Act, because they each hold over \$1,000 worth of stock in that company.

It is not clear from the facts whether they have a financial interest in that company which would preclude them from discussing the telecommunications contract. To make that determination requires further analysis of the terms of the Act, discussed below.

In contrast with analysis of potential "income" interests, which requires looking back 12 months prior to the date of governmental decisionmaking (Government Code section 87103(c)), an "investment" interest stops on the date the common stock, bond or other investment interest is sold or otherwise disposed of. Therefore, Mayor O'Connor did not have an investment interest in NEC Corp after October 21 1988, the date the Peterson trust sold the NEC stock. However, even though the Peterson trust disposed of the General Electric bonds in October 1988, she does have a continuing investment interest in General Electric/RCA arising from the Peterson Trust's acquisition of General Electric Capital bonds on October 21, 1988, because General Electric Capital is a subsidiary of GE/RCA. Again, just because the Mayor has a continuing investment interest in GE/RCA does not mean that she is disqualified from participating in discussions regarding the telecommunications contract. That determination can be made only after the following analysis.

II. Do Mayor or Councilmembers Have a Disqualifying Financial Interest?

Even if a public official has a "financial interest" that is somehow related to a governmental decision, that financial interest is not necessarily a disqualifying interest unless the terms of Government Code section 87100 and 87103 are met. In addition to finding a financial interest, Government Code section 87100 requires a determination that: 1. the public official made, or participated in making, a governmental decision or attempted to influence a governmental decision; and, 2. the public official knew or had reason to know that the governmental decision would have an impact on his or her financial interests. Third, Government Code section 87103 requires determining whether it was reasonably foreseeable that the governmental decision would have a "material financial effect" on those financial interests. Each of these requirements is discussed below.

A. Was There A Governmental Decision?

The first question to be determined is whether the actions of the Mayor and Council on May 16 and 30 were in the nature of making, or participating in making, a governmental decision, or attempting to influence one.

At the outset, it should be recalled that neither the Mayor nor Councilmember Henderson was present at the May 16 hearing. Councilmember Wolfsheimer, however, was present. All three (3) were present, participated and voted on May 30 according to the Clerk's records. The terms "public official making or participating in making a governmental decision" and "using official position to influence" are defined in FPPC regulations 18700 and 18700.1 (copies attached). The actions of May 16 and 30 do not appear to rise to the level of participation in a governmental decision within the meaning of Regulation 18700, because a City contract was not involved. However, there may have been an attempt to influence another governmental agency's (SDDPC's) action.

Under Regulation 18700.1, influencing a governmental decision includes "a governmental decision which is within or before an official's agency or an agency appointed by or subject to the budgetary control of his or her agency, in which the official is attempting to use his or her official position to influence the decision if, for the purpose of influencing the decision, the official contacts, or appears before, or otherwise attempts to influence, any member, officer, employee or consultant of the agency." Emphasis added.

SDDPC is a corporation wholly owned by the City of San Diego, and subject to the City's budgetary control. The ultimate governmental decision at issue is the award of the telephone vendor contract by SDDPC. Even though under the terms of the

operating agreement between the City and SDDPC, SDDPC alone was to select the telephone vendor for the City and Convention Center, documents on file with the City Clerk reveal that the Council's discussion and actions on May 16 and May 30 were an attempt to have SDDPC reexamine its bidding process used to select the successful bidder and ultimately to reopen the process to reconsider the other six (6) unsuccessful bidders. On May 30, the Council adopted two (2) resolutions (No. R-273618 and R-273620): one to recommend bifurcating the telephone vendor contract to allow the Convention Center to go forward; the second to in effect ask SDDPC to reconsider its bid process to allow all seven (7) bidders to submit a "final best offer." The Council agenda also contained a third resolution, one which would have

terminated the entire agreement between SDDPC and City. This third resolution was not adopted. The Mayor and Councilmembers Henderson and Wolfsheimer voted to adopt the two resolutions. Clearly, the action of the Council on May 30 was in the nature of influencing the bid process and ultimately the award of a governmental contract.

It is doubtful whether Councilmember Wolfsheimer's actions on May 16 rise to the level of attempting to influence a governmental decision. (Remember, Mayor and Councilmember Henderson were not present on May 16.) All that Councilmember Wolfsheimer did on May 16 was second an action by Councilmember Roberts and vote to direct the City Attorney to draft three (3) resolutions for discussion and consideration at a later date. We conclude that absent more facts showing the level of her participation on May 16, Councilmember Wolfsheimer was not attempting to "influence a governmental decision" within the meaning of Government Code section 87100 by her actions on May 16.

B. Did the Mayor or Councilmembers know or should they have known of a material financial effect on their respective financial interests?

A government official does not have a disqualifying financial interest in a governmental decision unless he or she knows or has reason to know that he or she has a prohibited financial interest.

As of the date the Mayor and Councilmembers' offices received Robert Metzger's May 10 memorandum, the Mayor and Councilmembers either knew or should have known the names of the seven (7) bidders on the telecommunications contract. Even though some of the names in the S.E.I.'s are not identical to the bidders' list, the names are similar enough to invite inquiry as to the relationship of the companies.

Therefore, we conclude that as of the date of receipt of the Metzger memo, the Mayor and Councilmembers knew or should have known the names of the bidders and should have been alerted to review their financial portfolios and S.E.I.'s for possible financial interests.

C. Was there a material financial effect on the financial interests?

Having determined that the Mayor and Councilmembers Henderson and Wolfsheimer knew or had reason to know that their

participation in the discussion and vote at the May 30 meeting would possibly impermissibly affect one of their financial interests, it is next necessary to determine whether it was reasonably foreseeable from their participation in the discussion and decision that there would be a material financial effect on their interests.

The FPPC has recently issued some revised regulations effective November 16, 1988, interpreting the meaning of "material financial effect". See 2 California Code of Regulations 18702-18702.6. While the rules are too lengthy to quote here, they are summarized below.

1. Was there a material financial effect on investments?

If the public official's investment interest is directly involved in the governmental decision, then Regulation 18702.1(a) applies to determine materiality. Regulation 18702 and 18702.1(a). The materiality of effect on investments in business entities not directly involved in a decision is determined by Regulation 18702.2.

A person or business entity is not directly involved in a decision before an agency unless that person or entity either:

1. initiates the proceedings before the agency; or, 2. is a named party or is a subject of the proceedings. Being the "subject of the proceeding" involves the issuance, approval, renewal, denial, or revocation of a license, permit or contract.

Regulation 18702.1(b)

Since the discussion and decision taken by the Council on May 30 did not "directly involve" either GE/RCA, GTE/GTEL, or NEC, the applicable regulation is 18702.2. In order to apply Regulation 18702.2 with certainty, it is necessary to know certain facts about the financial status (gross revenues, assets, whether its securities are traded on the NYSE, etc.) of the business entity in whom the public official has an investment. In the present case, however, the award of a \$12-18 million contract would necessarily have a significant impact on the gross revenues, assets or income of virtually any size business entity, ranging from the smallest to those listed with the SEC and traded

on the NYSE or ASE. There is no serious question that the award or failure to receive the award of the telecommunication contract will have a material financial effect on the investments held by the Mayor and Councilmembers Henderson and Wolfsheimer. Therefore, we conclude that the vote of May 30 would have a material financial effect on GE/RCA and GTE/GTEL, since they were unsuccessful bidders in the original proposal by SDDPC to award the contract to Siemens/Tel Plus.

2. Was there a material financial effect on Mayor's income interest?

We have determined that neither Councilmember Henderson nor Wolfsheimer had income interests within the meaning of the Act. But, as shown above, the Mayor may have income interests arising from the Peterson Trust's ownership and sale of NEC stock and sale of General Electric Corporation bonds in 1988. Hence it is necessary to examine whether her May 30 participation had a material financial effect on those income interests.

Again, from the above analysis of Regulation 18702.1(b), the Council's action of May 30 did not have a direct effect on the Mayor's income interests. However, when determining the impact on income interests, as opposed to investment interests, that regulation also requires examining whether there is a "nexus" between the purpose for which the official receives income and the governmental decision. Regulation 18702.1(a) and (d). There is such nexus only if the official "receives income to achieve a goal or purpose which would be achieved, defeated, aided or hindered by the decision."

In the present case, there appears to be absolutely no nexus between the Council's vote on May 30 and the reason for which the Mayor received income in the past 12 months from NEC or General Electric Corporation. On the contrary, the sale of NEC stock and General Electric Capital bonds was complete in October 1988. There could be no possible impact on NEC or General Electric Corporation as sources of income (as opposed to investments) by virtue of her vote on May 30.

Since we have determined that there would be no material financial effect on NEC or General Electric Capital as sources of income, assuming there was "direct involvement", there is no need to examine whether there would be a material financial effect on them as business entities under the "indirect involvement" rule, Regulation 18702.2.

CONCLUSION AND ENFORCEMENT RECOMMENDATION

I. Conclusion.

The Mayor has an investment interest in GE/RCA, one of the disappointed bidders for the SDDPC telecommunications contract,

because of her interest in the Robert O. Peterson trust, which owns bonds of General Electric Capital Corporation, a subsidiary of GE/RCA. Councilmembers Henderson and Wolfsheimer have an

investment interest in GTE/GTEL, one of the other disappointed bidders on the telecommunications contract. The Mayor may also have an income interest in NEC Corporation, because of the Peterson trust's prior ownership and sale of stock in that company, and a residual income interest in General Electric Corporation, because of the Peterson trust's prior ownership and sale of bonds in that company.

The actions of Councilmember Wolfsheimer on May 16 do not rise to the level of participating in influencing a governmental decision. However, the actions of the Mayor and both Councilmembers on May 30 were attempts to influence a governmental decision within the meaning of the Act, by exerting its influence on SDDPC to reopen the bid process to all seven (7) bidders on the telecommunications contract.

As of the date of receipt of the Robert Metzger memorandum, the Mayor and Councilmembers Henderson and Wolfsheimer knew or had reason to know who were the seven (7) bidders on the contract and the relationship of these companies to their financial holdings. Further the Mayor and Councilmembers Henderson and Wolfsheimer's actions on May 30 had a reasonably foreseeable material financial effect on their investment interests, although that is not true for the Mayor's income interests.

II. Enforcement Action Recommendation.

As a result of the above analysis, we have concluded that the participation by the Mayor and Councilmembers Henderson and Wolfsheimer in the May 30, 1989 vote resulted in a violation of the disqualification requirements of California Government Code section 87100. While violations of the Political Reform Act carry both misdemeanor and civil penalties under Government Code section 91000(b) and 91005(b), there is no evidence at this time to show that the Mayor or Councilmembers Henderson or Wolfsheimer intentionally or wilfully violated the statute. The presence of good faith should be taken into account in applying the Act's enforcement provisions, as section 91001(c) counsels:

(c) Whether or not a violation is inadvertent, negligent or deliberate, and the presence or absence of good faith shall be considered in applying the remedies and sanctions of this title.

In reviewing the evidence available to date, including both the purpose of the May 30 vote and the complicated and, at times, conflicting nature of the economic interests involved, we find

the Mayor and Councilmembers' failure to disqualify themselves resulted from both inadvertence and good faith. First, as chronicled in pages 5 through 10 of this memorandum, income and investment rules differ in application and effect and require amplification before a decision to disqualify can be made. Second, while the vote influenced a governmental decision, the effect of the vote on the financial interests (the companies in which the public officials have an interest) was speculative. After all, any reconsideration of the telecommunications bid by SDDPC could yield the same result. Hence, Councilmembers, while technically "influencing a governmental decision" within the meaning of the Act, could have plausibly assumed the vote was one of procedure and not of substance with no direct impact on the award of a contract.

Now that the nature and effect of these financial interests have been ascertained, however, the Mayor and Councilmembers Henderson and Wolfsheimer should disqualify themselves from participating in any future procedure that involves the consideration or reconsideration of the telecommunications bidding process or award.

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By

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Attachments (2)

ML-89-56