

ADVISORY OPINION NO. 88-5

An employee of a state department who may have become involved with public relations/marketing consultants to the department in their selection, duties, and direction, requested advice from the State Ethics Commission in light of her relationship with a corporate public relations/marketing firm and because of her husband's ownership of another public relations/marketing firm. The employee's husband's firm had contracted with the employee's department prior to the employee's employment with the department.

FACTS

The employee's relationship to the two public relations/marketing firms were described as follows:

A. The Corporate Public Relations/Marketing Firm

Previous to the employee's employment with the State, the employee had sold her shares of the corporate public relations/marketing firm's stock back to the corporation. The corporation paid the employee a sum at the outset, and provided the employee with a promissory note for the balance owed to the employee.

The owners of the other shares of stock of the corporation personally guaranteed payment to the employee in behalf of the corporation and gave the employee a security interest in their shares to secure their personal guarantee. The stock certificates were placed in escrow.

Also, by the terms of the redemption of the stock, as additional security, the corporation took out a life insurance policy on the employee's life with the employee as the primary beneficiary.

At the time of the redemption of the stock, the corporation entered into an agreement with the employee for employment and deferred compensation. In the agreement, the corporation was to employ the employee as chairman of the corporation for compensation. Also in the agreement, the corporation recognized the employee's contribution to the corporation's financial success which was cumulative over the years and which would continue after the employee's retirement, death, or total disability, and agreed to pay the employee deferred compensation. The deferred compensation was to be paid in consecutive monthly payments extending over a ten year period.

Also a part of the agreement was a covenant not to compete in which the employee agreed not to compete with the corporation within the State of Hawaii during the term of the employee's employment with the corporation and for a period of five years subsequent to the termination of the employee's employment from the corporation.

Subsequent to the employee selling her stock, she continued to do some work for the corporation but she retired in January 1986, terminating her employment with the corporation. The employee continued, however, to be a director of the corporation and an officer of the corporation as chairman of the board. The employee served in these positions without compensation. The employee retained her directorship and chairmanship because these positions gave the employee access to information regarding the finances of the corporation which allowed the employee to monitor the corporation's compliance with the terms of the corporation's agreements with the employee.

The employee also retained health, dental, and term insurance through the corporation, but the employee paid for all premiums herself.

B. The Employee's Husband's Public Relations/Marketing Firm.

The employee's husband's public relations/marketing firm is a sole proprietorship owned by the employee's husband. The employee had no interest in her husband's business.

In August 1987, prior to the employee's employment with the State, the employee's husband's firm contracted with the employee's department as a consultant. The department contracted with the firm and not with the employee's husband personally. The firm had a full staff of employees. The State was only one of its clients.

DISCUSSION

A provision of the ethics code which was applicable to the employee's relationship to both public relations/marketing firms was Hawaii Revised Statutes ("HRS"), section 84-14(a)(1) which states as follows:

§84-14 Conflicts of interests. (a) No employee shall take any official action directly affecting:

(1) A business or other undertaking in which he has a substantial financial interest;

Under the ethics code, "financial interest" is defined as follows:

"Financial interest" means an interest held by an individual, the individual's spouse, or dependent children which is:

- (1) An ownership interest in a business.
- (2) A creditor interest in an insolvent business.
- (3) An employment, or prospective employment for which negotiations have begun.
- (4) An ownership interest in real or personal property.
- (5) A loan or other debtor interest.
- (6) A directorship or officership in a business.

"Official action" is defined by the ethics code to mean "a decision, recommendation, approval, disapproval, or other action, including inaction, which involves the use of discretionary authority."

Under the corporate firm's by-laws, the chairman of the board was the senior officer of the corporation. Thus, as a director of the corporation and chairman of the board, the employee held a directorship and officership in a business which gave the employee a financial interest in the business under the definition of "financial interest." And the Commission had previously held that a directorship or officership amounts to a "substantial" financial interest because of the significant fiduciary responsibility owed by a director or officer to the business. (Advisory Opinions Nos. 300, 347, 348, 392, and 397.)

Inasmuch as the definition of "financial interest" imputes an employee's spouse's financial interest to the employee, the employee's husband's ownership interest in his firm as a sole proprietor was imputed to the employee. As to whether this financial interest was "substantial," the Commission had interpreted "substantial" to mean an interest of sufficient magnitude to be reasonably likely, in the circumstances, to influence an employee's official action. (Advisory Opinions Nos. 2, 9, 18, 22, 30, 39, 82, and 241.) Under this interpretation, in light of the employee's husband's sole ownership of the firm, the Commission found the employee's imputed ownership interest in her husband's firm to be of such magnitude as to be reasonably likely to influence the employee's official action. The employee was therefore found to have a substantial financial interest in the firm.

With respect to both public relations/marketing firms, therefore, HRS, section 84-14(a)(1) prohibited the employee from taking any direct official action affecting either firm in the employee's state capacity. HRS, section 84-14(a)(1) required that the employee disqualify herself from taking direct official action in regard to either firm. The employee indicated that the employee had discussed this matter with the director of her department and he had indicated to the employee that, administratively, it would not be difficult to insulate the employee from having to take direct official action in regard to these firms.

Another provision of the ethics code which was applicable to the employee's situation was HRS, section 84-15(a), which states as follows:

§84-15 Contracts. (a) A state agency shall not enter into any contract with a legislator or an employee or with a business in which a legislator or an employee has a controlling interest, involving services or property of a value in excess of \$1,000 unless the contract has been awarded through an open, public process. A state agency may, however, enter into such contract without resort to a competitive bidding process when, in the judgment of the agency, the property or services should not, in the public interest, be acquired through competitive bidding; provided that written justification for the noncompetitive award of such contract shall be made a matter of public record and shall be filed with the state ethics commission at least ten days before such contract is entered into.

With respect to members of boards, commissions, and committees, this subsection shall apply only to contracts entered into between a business in which a member has a controlling interest and a state agency which has jurisdiction over the board, commission, or committee to which the member is appointed.

The ethics code defines "controlling interest" to mean "an interest in a business or other undertaking which is sufficient in fact to control, whether the interest be greater or less than 50%."

In regard to the corporate firm, the Commission reviewed the provisions of the articles of incorporation and the by-laws of the corporation relating to the board of directors and the chairman of the board to determine whether the employee had a controlling interest in the corporation by virtue of the employee's membership on the corporation's board of directors and the employee's position as chairman of the board. The employee's current participation as a director and officer of the corporation was limited to attending and conducting the corporation's annual stockholders' and board of directors' meeting and voting on matters raised at the meeting. However, in reviewing the articles of incorporation and by-laws, the Commission had taken notice that as chairman of the board the employee was the senior officer of the corporation and that there were extensive powers authorized to the board of directors and chairman of the board. In particular, as a member of the

board of directors, the employee would participate in electing the officers and setting their salaries, which was viewed by the Commission as exerting control over this closely held corporation. Although there were other authorized powers which the employee may not have been presently exercising, these powers were nevertheless at the employee's disposal as a director and chairman of the board. The employee had also explained that the employee had retained her directorship and chairmanship in order to monitor the finances of the corporation. If the employee should have become aware of a matter which the employee did not agree with, the employee may have been able to exercise her vote within the corporation to affect the outcome, or to take action through her own lawsuit. The Commission, therefore, found that the employee did have a controlling interest in the corporate firm and that HRS, section 84-15(a) was applicable to contracts between state agencies, including the employee's department, and the corporate firm.

In regard to the employee's husband's firm, the Commission found that the employee did not have a controlling interest in the firm. It was clear that the employee did not have any ownership or management interest in the business. And to guard against the employee's acquisition of such interests, the corporate firm had entered into an agreement with the employee which required that the employee not compete with the corporate firm for a period of five years following her retirement from the corporation. We found, therefore, that HRS, section 84-15(a) did not apply to contracts between state agencies, including the employee's department, and the employee's husband's firm.

The Commission also noted that since the employee had no interests in her husband's firm, it was not necessary to review her husband's interest in the business to determine whether his interest would bolster the employee's interest in the business. While previous advisory opinions may have looked to an employee's spouse's interest in a business to determine whether the employee had a controlling interest in the business, these previous advisory opinions did not require that we do so in this opinion.

In Advisory Opinion No. 252, the Commission implied that the employee's spouse's interest would be considered in determining whether the employee had a controlling interest in the business for the purposes of HRS, section 84-15(a). In this advisory opinion, the Commission found that neither the employee or the employee's spouse had any management or ownership interest in the business and, therefore, did not apply HRS, section 84-15(a) to the situation. This opinion did not decide whether an employee's spouse's interest alone may give an employee a controlling interest in the business.

In Advisory Opinions Nos. 254 and 399, the Commission looked at an employee's spouse's interest in the business in determining whether the employee had a controlling interest in the business for the purposes of HRS, section 84-15(a). However, in both opinions, the employee himself had an interest in the business which in and of itself may be found to be a controlling interest. In Advisory Opinion No. 254, the employee was an officer and major stockholder of the corporation. In Advisory Opinion No. 399, while the primary financial interest was in the name of the employee's spouse, the Commission found that the employee himself had an interest in the business and that the employee would be participating in the operation of the business.

The Commission thanked the employee for consulting with the Commission and for requesting an advisory opinion. The Commission also commended the employee for her concerns regarding the ethics code.

Dated: Honolulu, Hawaii, April 12, 1988.

STATE ETHICS COMMISSION
K. Koki Akamine, Commissioner
Cynthia T. Alm, Commissioner
Rev. David K. Kaupu, Commissioner

Note: Chairperson Laurie A. Loomis and Vice Chairperson Arnold J. Magid were not present during the discussion and consideration of this opinion.