ADVISORY OPINION NO. 89-5

A state employee, who was the executive director of a state agency responsible for redevelopment activities in a particular area of the State, requested an advisory opinion in regard to her appointment to the board of directors of a private, non-profit organization. The staff of the State Ethics Commission ("Commission") first became aware of a possible conflict of interest while reviewing the employee's annual financial disclosure, which indicated the employee's acquisition of the directorship with the private organization. After staff discussed the circumstances with the employee, it was apparent that a conflict of interest issue had to be settled by the Commission, so the employee responded with a request for an advisory opinion.

The employee was appointed to the board of directors of the private organization on May 19, 1988. The employee served on the board without compensation. Subsequent to the employee's appointment to the board of the private organization, the employee's state agency, which was governed by a state board, contracted with the private organization to do the preliminary planning for two affordable housing projects being developed by the state agency and another state agency involved in developing housing projects ("state agency B"). The employee sought advice as to whether, under these circumstances, the employee could continue to serve on the board of the private organization while employed as the executive director of her state agency.

The private organization was established in 1980 to develop housing opportunities for low, moderate, and "gap-group" (people who do not qualify for government or regular financing) income households. The organization's objectives also included housing for special needs groups such as the handicapped and the elderly.

The private organization was initially funded by the federal government for two to three years, and currently received about fifty percent of its funding from the State. Other funds were acquired by the private organization through the counties, which received federal monies in the form of community development block grants; from consultant's fees earned from services rendered to government agencies and other nonprofit organizations which were developing housing in the categories targeted by the private organization; and from fees earned as a project manager whenever the private organization chose to rent rather than sell a project developed by the organization.

The executive director of the private organization explained that the organization wished to have the employee serve on its board because of the employee's expertise in housing. The executive director of the private organization felt that because the organization did housing on a statewide basis, the employee would, in turn, benefit from the employee's exposure to the types of housing the employee's state agency might want to develop in the district under the jurisdiction of the state agency.

The employee had been serving on the board of the private organization in her personal capacity. However, the employee, the private organization, and the state agency were in favor of having the employee serve in her state capacity.

The chairman of the state board that governed the employee's state agency ("state board") wrote to the Commission in support of having the employee serve on the board of the private organization in her state capacity as a representative of the state agency. The chairman pointed out that the private organization and the state agency both shared a common public purpose in

developing affordable housing in Hawaii. The chairman expressed that, given this common public purpose, it appeared reasonable that the employee serve on the board of the private organization as a representative of the state agency.

By becoming a member of the board of directors of the private organization, the employee acquired a "financial interest" in the private organization as "financial interest" is defined in the State Code of Ethics ("ethics code"), chapter 84, Hawaii Revised Statutes ("HRS"). The definition of "financial interest" states as follows:

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

Whenever an employee has a newly acquired financial interest or a prospective financial interest, the provisions of the ethics code which are considered for application are HRS section 84-14(a) and section 84-14(b). These conflict of interest provisions state as follows:

> **§84-14 Conflicts of interests.** (a) No employee shall take any official action directly affecting:
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> (1) A business or other undertaking in which he has a substantial financial interest; or
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> (2) A private undertaking in which he is engaged as legal counsel, advisor, consultant, representative, or other agency capacity.
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> A department head who is unable to disqualify himself on any matter described in items (1) and (2) above will not be in violation of this subsection if he has complied with the disclosure requirements of section 84-17; and
>
> A person whose position on a board, commission, or committee is mandated by statute, resolution, or executive order to have particular qualifications shall only be prohibited from taking official action that directly and specifically affects a business or undertaking in which he has a substantial financial interest; provided that the substantial financial interest is related to the member's particular qualifications.
>
> (b) No employee shall acquire financial interests in any business or other undertaking which he has reason to believe may be directly involved in official action to be taken by him.

"Official action" is defined in chapter 84 to mean "a decision, recommendation, approval, disapproval, or other action, including inaction, which involves the use of discretionary authority."

In reviewing the employee's acquisition of a financial interest in the private organization, it was first necessary to determine whether HRS section 84-14(b) was violated by the employee's acceptance of the directorship in the private organization. The issue was whether the employee had reason to believe at the time she joined the organization that the organization would be directly involved in official action to be taken by her in her state capacity. In reviewing the circumstances, however, it did not appear that HRS section 84-14(b) was violated. The sequence of events involving the employee's appointment as a director of the private organization and the state agency's contract with the private organization was as follows:

1. The funds to be used for the contract with the private organization were funds transferred to the state agency from another state agency ("state agency C") in 1979 for housing purposes, with a condition that the two state agencies would agree on the use of the funds.

2. The employee was appointed to the board of the private organization on May 19, 1988.

3. During the latter part of 1988, the development staff of the employee's state agency met with the staff of state agency B (which had been created to assume some responsibilities of state agency C), to come to an agreement as to the use of the funds. The agreement reached entailed expending the funds for housing feasibility studies and preliminary studies necessary to package housing projects that could be developed. The employee was aware of the meetings, but the employee was not aware that the private organization would be selected to carry out the studies. (This was the first time the state agency would be contracting with the private organization, and the first time the state agency would be taking any official action directly affecting the private organization.)

4. The employee was informed of the proposal involving the contract with the private organization about two weeks before the proposal was taken to the members of the state board for their decision-making. As executive director, the employee had to approve the proposal before it was taken to the members of the state board.

5. The proposal to do the study and the contract with the state agency were approved by the members of the state board in February 1989.

It appeared that the employee had no reason to believe, at the time the employee became a director of the private organization, that the private organization would be directly involved in official action to be taken by the employee. Therefore, the employee did not violate HRS section 84-14(b) by becoming a director of the private organization.

However, although HRS section 84-14(b) was not violated, HRS section 84-14(a) would normally require that state employees disqualify themselves from participating in official action which may directly affect a business in which the employee has a financial interest. Thus, the employee would normally be required to disqualify herself from participating in official action directly affecting the private organization. As the executive director of the state agency, the employee approved all matters going before the members of the state board. For example, the employee approved the proposal involving the contract with the private organization before the proposal was taken to the members of the state board. Thus, the employee did, technically, engage in official

action directly affecting the private organization, even though the employee was not a decision maker with respect to the proposal.

However, the Commission did not proceed to determine whether HRS section 84-14(a) was technically violated, in light of the conclusion reached by the Commission, discussed below, regarding serving as a director or officer of a private corporation in one's official (i.e., state) capacity. Furthermore, at the time the state agency decided upon awarding the contract to the private organization, the employee had brought the matter of a possible conflict of interest to the attention of the members of the state board, who indicated that they felt that there was no conflict of interest on the employee's part. It would have been prudent, nevertheless, for the employee or state board to have inquired with the Commission on this issue since the ethics code has specific provisions on conflicts of interests.

Under special circumstances, the Commission has not applied HRS section 84-14(b) or section 84-14(a) to employees who serve as an officer or a director of a private, nonprofit organization in the employee's state capacity as a representative of the State. Advisory Opinions Nos. 86-1 and 86-2 set forth guidelines which assist the Commission in determining whether HRS section 84-14(b) and section 84-14(a) should be applied where the employee serves in his or her state capacity as an officer or a director of a private corporation. These guidelines were not intended to be dispositive, but were established to clarify the factors to be considered by the Commission. These guidelines were articulated as follows:

(1) There is a valid state purpose that justifies a state agency's having one of its employees serve in a state capacity as a director or officer of a private corporation.

(2) The state agency authorizes in writing that serving as a director or officer of a private corporation is one of the official responsibilities of the state employee.

(3) The state employee who serves in an official capacity as a director or officer of a private corporation serves or acts solely on behalf of the State's interests.

(4) The state employee receives no compensation from the private corporation.

(5) The state employee has no financial interest in the private corporation.

(6) The state employee's service as a director or officer of the private corporation does not violate any of the provisions of the State Ethics Code.

(7) The question of whether a state employee may serve in a state capacity as a director or officer of a private corporation has been presented to the Commission, and the Commission has granted its approval.

In determining with respect to item 6 whether ethics problems are likely to arise if a state employee serves as a director or officer of a private corporation, the Commission will consider the following factors:

(a) **The purpose of the corporation.** The Commission believes that ethical problems are less likely to arise in situations where the private corporation has been created to further the public's interests as a whole or the interests of the State of Hawaii, rather than individual or private interests.

(b) **The funding source.** The Commission believes that ethical problems are less likely to arise in situations where the federal or state government, charities, or foundations fund the private corporation.

(c) **Whether the corporation is a profit or nonprofit corporation.** The Commission believes that ethical problems are less likely to arise when state employees serve as directors or officers of nonprofit corporations.

The circumstances of the employee's particular situation appeared to fall within these guidelines, including the issuance of a letter by the chairman of the state board which, in effect, authorized the state employee's directorship with the private organization in the employee's state capacity, in satisfaction of guideline number (2). However, an additional factor which was relevant to the employee's situation was the matter of competitors. Inasmuch as the possibility of competitors did not exist in previous situations reviewed by the Commission, a consideration of competitors was not included in the guidelines. A consideration of competitors, at this point, needed to be added to the guidelines. The consideration of competitors most logically fell under guideline number (6), as subsection (d).

The Commission's staff spoke with the development director of the employee's state agency, who was responsible for all of the state agency's development activities (except for infrastructure improvements such as sewer and water lines, roadways, etc.), to determine the extent to which the private organization may have had competitors for the contract with the state agency. The development director explained that the private organization had no true competitors. The private organization stood out above all nonprofit housing organizations because of the private organization's broad scope of expertise and outstanding ability in the area of project management. There were also no for-profit organizations competing for the contract. The state agency had made a decision to not consider for-profit organizations for the contract because of the concern for bias on the part of a for-profit organization and because of the large profit margin required by for-profit organizations.

While the existence of competitors would not necessarily be dispositive in determining whether HRS section 84-14(b) and section 84-14(a) should not apply to a situation, because the private organization had no competitors for the contract, this situation appeared to be similar to those situations in which HRS section 84-14(b) and section 84-14(a) were not applied. Thus, HRS section 84-14(b) and section 84-14(a) were not applicable to the employee's directorship with the private organization, and as executive director of the state agency the employee did not have to disqualify herself from participating in official action directly affecting the private organization. The employee, however, had to serve as a director of the private organization in the employee's state capacity as a representative of the state agency, representing the interests of the State; had to continue to not receive compensation from the private organization; and could not otherwise acquire a financial interest in the private organization. Additionally, although the development director indicated that he did not foresee the state agency contracting with the private organization again in the near future, should the possibility of a new contract with the private organization arise and the employee continued to serve as a director of the private organization, the employee had to either disqualify herself from participating in official action directly affecting the private organization, or the employee had to contact the Commission for a review of the circumstances existing at that time.

The Commission emphasized, as it had done in the past, that the guidelines did not provide for either automatic rejection or approval. Because the advice of the Commission is dependent upon the particular facts of the situation, the Commission requires that the Commission be consulted whenever an employee wishes to serve in the employee's state capacity as a director or officer of a private organization.

The advice provided herein was based upon the facts presented to the Commission by the employee and the employee's staff, the chairman of the state board, and the executive director of the private organization. The employee was advised that if the facts of her situation changed substantially, she should contact the Commission for a further review of the situation.

The Commission thanked the employee and the state agency for their cooperation in the matter. The Commission also appreciated the assistance of the private organization in providing information to the Commission. The Commission advised the employee that, if there were any questions, the employee should not hesitate to contact the Commission.

Dated: Honolulu, Hawaii, June 9, 1989.

STATE ETHICS COMMISSION
Cynthia T. Alm, Chairperson
Rev. David K. Kaupu, Vice Chairperson
K. Koki Akamine, Commissioner
Laurie A. Loomis, Commissioner

Note: There was a vacancy on the Commission when this opinion was considered.