

ADVISORY OPINION NO. 92-2

A state employee, who was a manager of a state office responsible for programs and projects intended to transfer technologies from the research level to private industry, asked for an advisory opinion in connection with these programs and projects. This employee explained that grants were awarded by his office to fund certain projects. In order to qualify for funding, the project had to show promise of producing a new or improved technology that could be transferred to the private sector for commercial exploitation when research was completed.

The employee presented three projects to the Commission for an opinion. All three were being considered by his office and all three involve state employees who had applied for funding in order to research a technology of his or her choice. In each case, the state employee applying for the funding had a financial interest in a private company that would be associated with his or her proposed project. As a result, if funding were granted, the state employee applying for the funding would be placed in the position of managing a project and conducting research that would directly affect a private company in which he or she held a financial interest.

The employee who requested the opinion explained that the three projects before the Commission came about as a result of Hawaii's policy to diversify its economy. This policy of economic diversification was reflected in a state law recently passed by the Legislature and signed by the Governor. This law appropriated a substantial sum of money to fund projects such as the three presented. The law also provided for continued funding over the next several years. This law also led to the establishment of the office of the employee requesting this opinion.

The office of the employee requesting this opinion described its mission as threefold: (1) support technology transfer from the public sector to the private sector for commercial development and application, (2) support science and technology-based business and economic development, and (3) support educational and innovative programs in science and technology. Included in the technology transfer mission of the employee's office were the protection of intellectual property by patents, copyrights, and licensing; a funding program to encourage state employees to participate in technology transfer and commercialization of their ideas and discoveries; and a technology assistance and deployment program to enhance the competitiveness of local business and industry.

Most of the projects submitted to the office of the employee who requested this opinion applied for funds under one of a number of specific programs. This particular program made funds available to state employees on a competitive basis, with commercial potential being the prime consideration. Private sector matching funds, joint venturing or partnering with industry and/or government was a specific requirement demanded of each proposal submitted to this program. All proposals were rigorously screened to assure soundness, both in terms of methodology and potential for commercialization. The State of Hawaii benefitted from this particular program by gaining patent rights to whatever technology was developed; the state employee who conducted the research benefitted by sharing with the State any royalties that resulted from the patent; and the private company providing matching funds

benefitted by gaining first right to any licensing agreement offered by the State to market the new technology.

A pervasive problem for projects that applied for funding under this program was securing matching funds from the private sector. As a practical matter, private capital was all but impossible to obtain because the risk of loss was significant. Success of these projects depended upon several factors, including not only venture capital but also commercial possibilities inherent in the technology, the skill of the researcher, and competence of project management. Furthermore, most projects involved long-term efforts, thus extending the period of risk and uncertainty to a degree generally unacceptable to the venture capital market.

As a result of private sector reluctance, state employees who were eligible to seek grants began to form their own companies in order to provide a vehicle to meet program requirements for matching funds from private enterprise. Not only was this practice known to the state office that administered this program, it was both encouraged and facilitated. One way in which this was done was through a relaxation of the matching funds requirement. Instead of asking that private enterprise match state funds on a dollar-for-dollar basis, the program allowed a lesser matching ratio such as two state dollars for every dollar put up by the private company. Moreover, the state office in charge of these programs placed a dollar value on the in-kind services to be provided by the state employee who sought the grant and allowed that figure to represent all or part of the private sector matching funds.

The employee who requested the opinion brought three specific projects to the Commission's attention. The first involved a state employee who submitted a proposal that sought a sum of money to conduct research in a certain area of aquaculture technology. Matching funds were to be provided in the form of in-kind support by the private company that entered into the joint-venture with the State. The employee who sought the grant held a financial interest in that private company. If the project were approved, the employee who sought the funding would be placed in the position of undertaking research that would directly affect the company in which he held a financial interest. His research would be part of his state duties and he would receive his state salary for his work. He would have total discretion over the nature and direction of the research aspects of the project. He would interpret findings, derive conclusions, and determine the subsequent direction of these research activities. He would also control the hiring and procurement practices of the project, subject to administrative oversight. Grant money allotted to the project would be distributed by the State to cover actual project costs, such as special equipment, project staff salaries, and operating costs.

The Commission was informed that during the period of research, the state employee who sought the grant would take little, if any, discretionary action directly affecting the private company that would enter into the joint venture with the State. If the technology proved successful, the state employee who sought the grant would likely leave state employment for full-time employment with his company. If, on the other hand, the technology were unable to support a commercially viable business, the employee would abandon his efforts and continue employment with the State.

If all the necessary approvals were obtained, the State would enter into a contract with the private company for the purpose of implementing the joint-venture. The contract would

give the State title to any patents that derived from the research. The employee would receive half of the net royalties flowing to the State from the patent, and the state would grant a license to the private company for commercial exploitation of the patent.

The second project brought to the Commission's attention involved a state employee who applied for a grant to study genetic engineering for pharmaceutical purposes. The grant asked for a sum of money, with matching funds to be put up by a company that would be formed if the grant were approved. The employee who sought the grant would be a principal in that company. This employee would have same kinds of authority and responsibilities as the employee who applied for funds under the first proposal. He would interpret findings, derive conclusions, and determine the subsequent direction of research activities, and subject to fiscal oversight, control hiring and procurement practices. If the technology proved to be commercially viable, the state employee who sought the grant would likely leave state employment for full-time employment with the private company. If the employee determined that the technology was not commercially viable, he would abandon his efforts and continue full-time employment with the State. In other respects, this proposal was similar to the first. The State would enter into a contract with the private company for the joint venture. The State would receive title to any patents, and the employee who put forth the proposal would receive half of the net royalties that flowed to the State as a result of those patents. The private company would be entitled to a license to commercialize the technology.

The third project involved an application for a grant for the purpose of developing space and electronic technology. If this proposal were approved, a state employee involved in the project would be placed in a position of taking official action directly affecting a company in which he held a financial interest. Unlike the first two proposals, the employee in this case would not be the primary researcher but would assist the primary researcher on matters of engineering. Moreover, private sector matching funds would not come from the employee's company, but from a third company in which the state employee held no financial interest. However, the company in which the employee held a financial interest would be offered a license to commercial rights to any patentable technology as a result of a contract between the company in which he held a financial interest and the company that would provide the matching funds. Matching funds would be provided in the form of in-kind support, rather than dollars. The State would enter into a joint-venture contract with the two private companies. The State would retain title to any patents and the inventors would be entitled to half of the net royalties. The employee's company would be given the right to an exclusive license to market any patentable technology.

The employee who asked for this opinion explained that his office had considered the potential ethical problems that could arise with these and other similar proposals. He explained that his office concluded that eight possible ways existed in which a state employee or state office administering the program could attempt to take advantage of the proposal in an unethical manner. These included:

1. Change the direction of the research to investigate topics outside the scope of the project but nonetheless of commercial interest to the employee's company.
2. Influence project staff to investigate topics that are of commercial interest to the employee's company but outside the scope of the project.

3. Restrict or unduly delay publication of research conducted.
4. Fail to disclose to the State any patentable inventions developed by the employee and "pipeline" those inventions to the employee's company.
5. Fail to fulfill commitments to the State by assuming more than an advisory or consulting role in the employee's company.
6. Grant overly favorable terms or other preferential treatment to a spin-off company in which the State has a financial interest.
7. License future inventions developed by someone other than the state employee to a spin-off company in which the State has a financial interest without prior consideration of other companies.
8. Fail to enforce policies governing the entrepreneurial activities of employees when such enforcement negatively impacts a spin-off company in which the State has a financial interest.

Depending upon the nature of the potential pitfall, the employee seeking this opinion explained that one or more of ten different state offices had responsibility for oversight to guard against such violations.

The employee asking for this opinion explained that although the three projects brought to the Commission's attention resulted from state programs and, that these programs were the direct result of state policy to encourage diversification of Hawaii's economy through technology transfer, the employee was nevertheless concerned that the proposals might place the state employees who sought the grants at odds with the ethics code.

The Commission said that several ethics code issues were presented by the three proposals. The first, a set of issues, centered around HRS section 84-14, conflicts of interests, specifically sections 84-14(b), 84-14(d), and 84-14(a). These read 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;

....

(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.

....

(d) No legislator or employee shall assist any person or business or act in a representative capacity for a fee or other compensation to secure passage

of a bill or to obtain a contract, claim, or other transaction or proposal in which he has participated or will participate as a legislator or employee, nor shall he assist any person or business or act in a representative capacity for a fee or other compensation on such bill, contract, claim, or other transaction or proposal before the legislature or agency of which he is an employee or legislator.

HRS section 84-14(b) prohibits a state employee from acquiring a financial interest in any business which he has reason to believe may be affected by official action to be taken by him. The code defines financial interest to include, among other things, an ownership interest in a business, which all of these employees clearly had. The code also defines official action. The term means a decision, recommendation, approval, disapproval, or other action, including inaction which involves the use of discretionary authority. The Commission noted that the research and administrative duties that these employees had under the three proposals constitute official action that would directly affect the businesses in which they held financial interests. Moreover, not only did the three have "reason to believe," as required by HRS section 84-14(b), they had actual knowledge that their businesses would be directly affected by official action to be taken by them as state employees.

HRS section 84-14(d) prohibits an employee from assisting a business or representing it for compensation to secure a contract or proposal in which he will participate as an employee, and from so assisting or representing for compensation before the agency of which he is an employee. In these cases, the three employees were not only the prime movers in developing the proposals in which they would participate as employees, they would also represent the companies for potential compensation before the agency of which they were employees.

HRS section 84-14(a) prohibits an employee from taking any official action directly affecting a business in which he has a substantial financial interest. In each of these cases, the employee, as part of his state duties, would be required to take official action, essentially discretionary action, directly affecting the business in which he had a substantial financial interest. In fact, the success of the venture depended largely upon the employee's discretionary action in each case.

The Commission stated that were it not for the fact that the State of Hawaii stood to benefit from these three projects as a joint-venturer, the conflicts of interests laws would prohibit the three state employees who sought these grants from (1) acquiring financial interests in the businesses which they had reason to believe may be directly involved in official action to be taken by them (HRS section 84-14(b)), (2) from taking any official action directly affecting those businesses (HRS section 84-14(a)), and (3) from assisting those businesses or representing those businesses for compensation on matters in which the employee had participated or would participate, and from so assisting or representing before the agency of which they were employees (HRS section 84-14(d)). The Commission has ruled in the past, however, that when the State of Hawaii stood to benefit from arrangements in which an employee acquired a financial interest subject to his official action, or took official action directly affecting that interest, or assisted or represented a business on a matter in which the employee had participated or would participate, or assisted or represented that business before

the agency of which he or she was an employee, the conflicts of interests law did not *per se* prohibit such arrangements, so long as the State's interest was adequately protected.

In Advisory Opinion No. 445, for example, an administrator of a state program served as an uncompensated officer of a private, non-profit organization subject to his official action. The Commission found that a benefit accrued to the State from the inter-relationship of the non-profit organization to the state program and that the non-profit organization was, in a sense, a state organization. The Commission, therefore, ruled that HRS section 84-14(b) should not be interpreted to apply in those circumstances. Thus, the administrator was permitted to continue to serve as an officer of the private, non-profit organization.

Similarly, in Advisory Opinion No. 88-8, the Commission ruled that another private, non-profit organization could be staffed by an employee of the State. This employee was permitted to become an officer in that organization, subject to the supervision of the employee's state supervisor. The employee was to receive no compensation from the private, non-profit organization, but was to continue under his state salary with his duties expanded to include work as an officer of the private, non-profit organization. The Commission found that the private, non-profit organization served a variety of important state purposes. As a result, the Commission ruled that the interest of the State was so overriding that HRS section 84-14 should not be interpreted to apply in those circumstances, notwithstanding the employee's code-defined financial interest in the private, non-profit organization, so long as adequate administrative safeguards were put in place to prevent abuse.

The Commission noted that other examples of Commission rulings that HRS section 84-14, conflicts of interests, should not be interpreted to apply in particular circumstances could be found in Advisory Opinions Nos. 86-1 and 86-2. In those two, the Commission ruled that state employees who wished to serve as directors or officers of certain non-profit corporations in their state capacities could do so under certain conditions, notwithstanding that these directorships or officerships gave these employees financial interests in organizations which were subject to their official action. The Commission explained its reasoning in these two opinions by saying:

It is not clear, ... whether when drafting HRS section 84-14(b) the Legislature had envisioned the situation in which state employees serve as directors or officers of private corporations as part of their state duties. Because state employees serve in their official capacities as directors or officers of private corporations have no "personal" financial interest in the corporations, the Commission believes that HRS section 84-14(b) does not necessarily prohibit them from accepting directorships or officerships with the private corporations
....

In the first of these two cases, Advisory Opinion No. 86-1, the Commission allowed a state official to serve in his state capacity as the president of a private, non-profit corporation that had been established and funded by the Legislature to accomplish state goals but which was subject to official action taken by the state official. In Advisory Opinion No. 86-2, a state official was allowed by the Commission to serve in his official capacity as a member of the board of directors of a private, non-profit corporation. This opinion confirmed Advisory Opinion No. 280 in which a state employee holding the state official's position at

that time was permitted to serve in his state capacity as a board member of the private corporation even though the employee's department occasionally entered into contracts with the corporation for services and even though the employee was responsible for approving and monitoring the contracts.

Each of the aforementioned advisory opinions addressed situations in which the employee was permitted to take official action directly affecting his or her code-defined financial interest. In each case, however, that financial interest was not "personal" in nature, meaning that under no circumstances did the employee in question stand to gain a personal financial benefit as a result of any official action on his part. The Commission noted that this was not true of the three projects considered herein. The opposite was the case. The employees who sought the grants in these three proposals and who would take official action directly affecting their respective financial interests not only stood to gain personal financial benefits from their actions as state employees, they hoped to do so.

Thus, the Commission had to address the question of whether the circumstances presented by these three proposals would allow the same rationale employed in the aforementioned advisory opinions to be applied in this instance, notwithstanding that the three employees in these proposals stood to gain personal financial benefits from their actions as state employees. For reasons set out below, the Commission concluded that the rationale employed in the prior advisory opinions should be applied to these three proposals as well. To begin with, the Commission noted that although it was clear that when drafting HRS sections 84-14(b), 84-14(d), and 84-14(a), the Legislature intended to prohibit a state employee (1) from acquiring a financial interest in a private company subject to his official action, (2) from taking official action directly affecting a business in which he has a substantial financial interest, and (3) from assisting or representing that business on matters in which he has participated or will participate, or on matters before the state agency of which he is an employee, it was not clear that the Legislature considered the circumstances of a joint-venture between a state agency and a private company in which the State stood to reap benefits from such an arrangement. The Commission believed that the Legislature may have intended to address solely and specifically those circumstances in which state employees stood to gain through their private financial interests to the detriment of the State and other citizens. This proposition seemed particularly plausible to the Commission in light of the fact that the Legislature appropriated funds and enacted a law that supported innovation, research and marketing of inventions and discoveries developed by state employees with the help of state money at state facilities and directing the State to support the transfer of these technologies to the private sector in order to promote economic development.

The Commission noted that for economic reasons, the only feasible way of achieving the goal set out by the Legislature would be to allow state employees, in joint ventures with the State, to form private companies in which they held a financial interest and which would be subject to their official action. Private sector collaboration, a specific program requirement, was not obtainable in any other manner. The Commission also noted that the employee's private company stood to benefit from these joint ventures only if the employee were successful in producing a patentable invention that lead to a license being awarded to the employee's company for marketing purposes, followed by successful marketing of the product. But such a license could only be awarded if a patent issued to the State of Hawaii and with that patent, half of the royalties and any licensing revenues it produced. Thus, the

Commission concluded that with adequate administrative safeguards in place, the private company in which the researcher held a financial interest could not benefit from the employee's official action unless the State of Hawaii did, as well.

In view of this concordance of interests, the Commission held that the three cases presented did not create any *per se* violations of HRS sections 84-14(b), 84-14(a), or 84-14(d) for the following reasons:

1. State policy encouraged commercialization of the technologies described in these three proposals.
2. The three proposals represented joint ventures between the State and the private company designated in each proposal, with the result that the State stood to benefit from the joint venture.
3. With adequate administrative safeguards in place, the private company in which the employee held a financial interest would not benefit unless the State of Hawaii did, as well.
4. The employee's financial interest in the private company was disclosed at the time the proposal was submitted for consideration and before the contract was entered into.
5. A valid state purpose justified the employee taking official action directly affecting a business in which the employee held a financial interest under circumstances in which the State and that business had entered into an agreement.
6. The State authorized in writing that such official action was to be part of the state duties of the employee.
7. The official action to be taken by the employee was limited to the period of time representing the transition of the technology to the private sector.
8. Any official action to be taken by the employee was subject to strict oversight and review by appropriate State authorities for the purpose of insuring that such official action would be directed toward the stated goals of the proposal.
9. The Commission reviewed each proposal.

The Commission also noted that other provisions of the State Ethics Code were also relevant in these circumstances. Two of these were concerned with actions of the state agency rather than the state employee. The first of these, HRS section 84-15(b), reads:

§84-15 Contracts.

....

(b) A state agency shall not enter into a contract with any person or business which is represented or assisted personally in the matter by a person who has been an employee of the agency within the preceding two years and who participated while in state office or employment in the matter with which the contract is directly concerned.

This section of the code prohibits a state agency from entering into a contract with any person or business which is represented or assisted personally in the matter by a person who has been an employee of the agency within the preceding two years and who participated while in state employment in the matter with which the contract is directly concerned. The Commission noted that section 84-15(b), essentially a post-employment restriction, was analogous in its restrictions to section 84-14(d), which applied to current state employees. The Commission addressed the applicability of HRS section 84-14(d) to these projects earlier in this opinion. It ruled that HRS section 84-14(d) should not be interpreted to apply to the three proposals. The Commission believed that the same rationale justifying its holding that HRS section 84-14(d) should not be interpreted to apply in these circumstances also justified a holding that HRS section 84-15(b) likewise should not be interpreted to apply in these circumstances, and the Commission so held.

HRS section 84-15(a), Contracts, was also relevant. It states:

§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 \$4,000 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.

HRS section 84-15(a) prohibits a state agency from entering into any contract with an employee or with a business in which the employee has a controlling interest, involving services or property of a value in excess of \$4,000, unless the contract has been awarded through an open, public process. This provision does, however, allow a state agency to enter into such a contract without resort to competitive bidding when, in the agency's judgement, the property or services should not, in the public interest, be acquired through competitive bidding. Under such circumstances, the agency is required to provide written justification for the non-competitive award of the contract and that justification is to be made a matter of public record and filed with the Commission at least ten days before the contract is entered into. The Commission took that opportunity to clarify that any licensing agreement arising out of the three projects considered herein or other similar proposals would require the State agency entering into those agreements to comply with the provisions of HRS section 84-15(a).

Finally, the Commission pointed out that HRS section 84-13, Fair Treatment, was also relevant. It states, in pertinent part:

§84-13 Fair treatment. No legislator or employee shall use or attempt to use the legislator's or employee's official position to secure or grant unwarranted privileges, exemptions, advantages, contracts, or treatment, for oneself or others;

HRS section 84-13 prohibits an employee from using or attempting to use his or her official position to grant anyone, including the employee, an unwarranted benefit. In the context of these three proposals, the Commission declared that this section, in addition to its general application, was interpreted to specifically prohibit any employee from deviating from the requirements of the project approved by the State in order to grant anyone, including himself, an unwarranted benefit.

The Commission cautioned that it may at its discretion review this opinion whenever it deemed that circumstances warrant. By the same token, the Commission notified the state agency administering this program that any changes in the material facts or circumstances as presented to the Commission in the three proposals required that state agency to consult with the Commission in order to avoid the possibility of running afoul of the State's ethics code. The Commission also requested that all future proposals be submitted to the Commission for review, in order to assure compliance with our State's ethics laws.

The Commission thanked the employee and his colleagues for their efforts in bringing this matter to the Commission's attention.

Dated: Honolulu, Hawaii, April 29, 1992.

STATE ETHICS COMMISSION
K. Koki Akamine, Chairperson
Barbara J. Tanabe, Vice Chairperson
Rev. David K. Kaupu, Commissioner
Laurie A. Loomis, Commissioner

Note: Commissioner Cynthia T. Alm disqualified herself from consideration of this matter.