

## ADVISORY OPINION NO. 94-2

A state employee requested an advisory opinion from the State Ethics Commission about a private corporation established by other employees of his agency. The employee's agency trained people to provide certain services to clients. The employee explained that his agency was somewhat unique from its counterparts on the mainland because it did not have its own training facility. Most similar agencies on the mainland had their own facilities. These facilities basically served two functions. First, they generated revenue for the agency. Clients of these facilities paid fees and these fees were normally dedicated to the agency. Money raised by a facility was used for agency programs and for the salaries of agency employees. The revenue generated by an agency facility allowed the agency to maintain a large staff. Second, agency facilities served as a training ground for those being trained at the agency. These people had an opportunity to accompany the agency's employees to the facilities and observe the provision of services to the clients.

In place of its own facility, the agency entered into agreements with different private facilities in the State. These agreements provided that the agency was to pay the facility to allow agency employees and apprentices to use the facility's clients and its grounds and equipment for training purposes. The agency paid the facility for the use of the grounds and equipment and also paid them for the administrative costs involved in allowing the apprentices to accompany the employees. These administrative costs were paid on a per capita basis; the agency paid the facility a certain amount of money for each apprentice it assigned to the facility.

The employee who requested this opinion informed the Commission that the agency was seeking to expand its personnel and to change the emphasis of its training. The agency employed both part time and full time staff. Full time employees were generally compensated from the budget of the agency. The employee explained that any service provider in the industry who allowed apprentices to observe him with clients was usually considered a member of the staff of the agency. The majority of these service providers were part time staff members who had associations with different private facilities. These service providers were compensated for their training work by the agency. However, because these service providers generated revenue for their facility at the same time that they were training, the facility reimbursed the agency for their salaries. Thus, the part time staff members were indirectly compensated from sources outside the agency.

Much of the training of the apprentices had involved accompanying service providers on their visits to clients at the facilities. Because their training involved clients who often required a specific service, the agency tended to turn out trained people who had specialized skills. These people frequently moved to the mainland where there were greater opportunities in the specialized fields. In response to this exodus, the agency decided to focus more of its efforts into training apprentices to provide services in more general areas. In order to do this, the agency needed to seek out clients in need of more generalized services.

In an attempt to increase the size of the agency's staff and to capture clients in need of generalized services, the employees of the agency formed a non-profit corporation. The board of directors of corporation was made up of full time employees of the agency who were the heads of different sections in the agency. Two members of the board of directors also served as officers of the corporation. The corporation was to consist of members who were service providers. Some of these service providers were part time employees of the agency. Others were not affiliated with the agency at the time they became members of the corporation. This scheme was not unique. Counterpart agencies in several other states had also established this type of corporation. In all cases, a private nonprofit corporation consisted of service providers who provided staff services to private facilities. The facilities paid the corporation which then channeled the money to the agency.

The plan required the agency to enter into an agreement with the corporation as it did with the private facilities. The agreement would provide, among other things, that the corporation's

service providers would train the apprentices. The agency would pay the corporation for the costs associated with doing this. The agency would also pay the corporation for other services relating to the staffing of different facilities.

The corporation would then seek contracts with private facilities that received clients in need of generalized services. These contracts would provide that the corporation would offer staff services for the facilities. The employee who requested this opinion said that there were basically two ways in which the corporation could capture clients in need of generalized services. The first way was through a state program. The program had not yet been implemented. If established, it would attempt to provide services to a certain population. This population would likely be people in need of generalized services. The employee explained that the State would let out one or, more likely, several contracts to provide services to these people. Private facilities and others would bid on these contracts. If a facility was successful in its bid for the program, then that facility would be responsible for providing services to the population covered by the program. The State would pay the facility to provide services for these clients. Under a contract with one of these facilities, the corporation would be paid by the facility to provide staff services. Any fees earned by the corporation's service providers would be assigned to the corporation. The money earned by the corporation would then be given to the agency which would use the money in part to pay the salaries of the corporation's service providers. The corporation's service providers would then be considered employees of the agency.

The second way in which the corporation could capture clients in need of generalized services was through contracts with private facilities that tended to receive these types of clients. There was no guarantee that the state program would be implemented. If it was not, then the corporation would seek to provide staff services to these private facilities. Again, any fees would be assigned to the corporation. The money earned by the corporation under the staff services contract would be given to the agency. The agency would use the money to pay the salaries of the corporation's service providers. The service providers would be considered employees of the agency.

The corporation would be guided by its officers and directors, all of whom were full time employees of the agency. Their service on the corporation raised issues under Hawaii Revised Statutes (HRS) section 84-14(b), part of the conflicts of interests section of the state ethics code. This section reads:

§84-14 Conflicts of interests. (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.

Section 84-14(b) forbids a state employee from acquiring a new financial interest in a business if the employee has reason to believe that he will be called upon to take official action affecting that business. Under section 84-3 of the ethics code, non-profit organizations are considered "businesses." Section 84-3 defines the term "financial interest" as:

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 property.
- 5) A loan or other debtor interest.
- 6) A directorship or officership in a business.

Under this section, a directorship or officership in a business is included as a financial interest. HRS section 84-14(b) would therefore forbid an agency employee from becoming a director or officer of the corporation if the employee had reason to believe that he would be taking official state action affecting the corporation.

Official action is defined by the ethics code as any action involving the use of discretionary authority. The employee who requested the opinion indicated that it would be difficult to distinguish between an individual's roles as an employee and as a director or officer of the corporation. The employee explained that there was a reason why the directors and officers of the corporation were all the heads of different sections in the agency. This scheme allowed the agency to keep control over the corporation. The members of the corporation would be training apprentices. The directors of the corporation would have the power to ensure that this training was adequate and met certain standards. Directors of the corporation could determine which service providers should be assigned to which facilities and which apprentices should be assigned for training to which service providers.

The employee's explanations indicated that the agency's staff would be taking action affecting the corporation. However, it appeared that there was not a clear demarcation between the roles of a state employee and of a director or officer of the corporation. The employee confirmed that directors of the corporation would serve on the board in their state capacity. Officers of the corporation were also expected to act in a manner that furthered the interests of the agency. In the past, the Commission had considered situations in which state employees served as officers or directors of private corporations as part of their state duties. In Advisory Opinion No. 86-1, the Commission considered a situation in which a state employee sought to serve on the board of directors of a private non-profit corporation in his state capacity. The Commission considered section 84-14(b) and stated:

It is not clear, however, whether when drafting HRS §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 who serve in their official capacities as directors or officers of private corporations have no "personal" financial interests in the corporations, the Commission believes that HRS section 84-14(b) does not necessarily prohibit them from accepting directorships or officerships with private corporations.

The Commission went on to say that in determining whether the acquisition of the new financial interest was appropriate, a number of general principles should be examined. The principles were not meant to be dispositive, but were instead designed to assist the Commission in reaching a decision. The basic principles articulated by the Commission were that employees who served on these corporations should act solely on behalf of the State's interests, that they should not be compensated for their services, and that they should get clearance from the Commission before becoming directors or officers.

The Commission also stated that in determining whether it was appropriate for a state employee to serve on a corporation in his state capacity, the Commission should consider whether ethics problems are likely to arise. The Commission said that it would consider three factors:

- (1) The purpose of the corporation. The Commission believed that ethical problems were less likely to arise in situations where the private corporation had 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.
- (2) The funding source. The Commission believed that ethical problems were less likely to arise in situations where the federal or state government, charities, or foundations funded the private corporation.

- (3) Whether the corporation is a profit or nonprofit corporation. The Commission believed that ethical problems were less likely to arise when state employees served as directors or officers of nonprofit corporations.

Again, these factors were not intended to be dispositive. They were instead meant to assist the Commission in making a determination.

The Commission believed that the current situation was quite similar to the one in Advisory Opinion 86-1. In both cases, state employees were seeking to serve on private corporations in their state capacities. According to Advisory Opinion No. 86-1, in deciding whether the agency's employees should be allowed to do this, the Commission should first examine whether the employees would be acting on behalf of the State and whether they would be compensated. The Commission should next determine whether ethics problems are likely to arise as a result of their service on the corporation.

The employee who requested this opinion affirmed that the agency's employees would be acting on behalf of the agency in their service on the corporation. The heads of the different sections in the agency would be placed in directorship and officership positions in order to give the agency control over the corporation. Apprentices would accompany the corporation's service providers as they saw clients. It was necessary for the agency to have some control over the corporation in order to ensure that the apprentices were being adequately trained.

The employee also said that the employees of the agency would not be paid by the corporation for their service as directors or officers. The employee did mention, however, that employees of the agency are entitled to perform a limited amount of private work. If an agency employee chose to perform private work for the corporation, then he might receive compensation from the corporation for this work. This, however, would be a separate matter from his service as a director or officer. Any compensation given to an agency employee as a result of his private work would be payment in exchange for other professional services unrelated to his service as an officer or director.

The Commission also had to consider whether ethical problems were likely to arise as a result of the employees' service on corporation. The Commission noted that problems were not likely to arise when the purpose of the corporation was to further the interests of the State or of the people of Hawaii. The Articles of Incorporation of the corporation specified the purpose of this corporation. According to the articles, the corporation was organized primarily to train apprentices, to provide services to a particular population, and to increase the staff of the agency. Money collected by the corporation was to be given to the agency and used to pay staff salaries and fund agency programs. This information indicated to the Commission that the corporation was specifically created to serve the state purpose of supporting the agency.

Ethical problems were also less likely to arise if the funding came from governmental or charitable sources. It was possible that the corporation would receive funds from both private facilities and governmental sources. If the state program was implemented, then the corporation would receive funding primarily from government sources. If it was not implemented, then the corporation would receive funding from private facilities. The corporation would also have other sources of income which would be primarily governmental. The corporation would provide staff services to both federal and State facilities.

Finally, the Commission noted that ethical problems were less likely to arise when the corporation was a nonprofit corporation. This corporation was organized as a nonprofit corporation. It was organized exclusively for scientific, educational, and charitable purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1986.

All of this information indicated that the employees of the agency should be allowed to serve as directors and officers of the corporation. Their service on the corporation would allow the agency to control the corporation. The employees would be able to ensure that the training of the apprentices was adequate. They would also be able to guide the corporation in its attempt to capture clients in need of generalized services. The employees would not be compensated by the corporation for their service as directors or officers. The corporation existed for the purpose of serving the interests of the agency. Money earned by the corporation would be channeled to the agency and used for the benefit of the agency. In short, by serving on the corporation in their state capacities, the employees would be advancing the agency's interests. For this reason, the Commission believed that they should be allowed to serve.

The Commission was somewhat concerned, however, about the possibility of agency employees being compensated for private work performed for the corporation. HRS section 84-14(b) forbids the acquisition of a financial interest in a business if the employee has reason to believe that he will be taking official action affecting that business. The Commission believed that if an agency employee was privately compensated for providing services to the corporation, then this could raise issues under HRS section 84-14(b). If a state employee wished to be privately compensated by the corporation, then he should check with the Ethics Commission about the application of HRS section 84-14(b). The Commission stressed that this opinion only addressed the situation in which agency employees served as directors or officers of the corporation.

The Commission also advised that in addition to section 84-14(b) several other sections of the conflicts of interests law generally applied whenever a state employee has outside financial interests. Section 84-14(a) reads, in relevant part:

§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....

This section forbids a state employee from taking any official action directly affecting a business in which he has a financial interest. As in the case of section 84-14(b), however, it appeared that this section was not meant to forbid state employees from taking action affecting corporations that they are serving in their state capacities. The Commission believed that if such a prohibition were in place, it would defeat the purpose of having state employees serve on these corporations.

Section 84-14(d) was also a concern. This section reads:

§84-14 Conflicts of interests. (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.

Section 84-14(d) forbids state employees from being compensated to assist or represent another on a matter before their own agencies, or on a matter in which they have participated or in which they will participate in their state capacities. Again, however, it appeared that application of this section would make little sense in this context. Work performed by the corporation and its members served the state purpose of benefitting the agency. Thus, in assisting the corporation, its members ultimately would be assisting the State. The Commission believed that it would make little sense to forbid the employees from assisting the corporation before the agency when the corporation was

itself created to assist the agency. Because the corporation served a state purpose, the Commission believed that section 84-14(d) was not meant to apply to this type of situation.

It seemed clear that the agency employees would be serving on the corporation in their state capacities. For this reason, the conflicts of interests provisions of the ethics code would not forbid them from serving as officers and directors of corporation. The Commission noted, however, that other sections of the ethics code may have general application. In particular, the Commission believed that the agency's employees should be aware of section 84-13 which reads:

§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; including but not limited to the following:

- 1) Seeking other employment or contract for services for oneself by the use or attempted use of the legislator's or employee's office or position.
- 2) Accepting, receiving, or soliciting compensation or other consideration for the performance of the legislator's or employee's official duties or responsibilities except as provided by law.
- 3) Using state time, equipment or other facilities for private business purposes.
- 4) Soliciting, selling, or otherwise engaging in a substantial financial transaction with a subordinate or a person or business whom the legislator or employee inspects or supervises in the legislator's or employee's official capacity.

In general, section 84-13 forbids a state employee from using his position to grant himself or anyone else an unwarranted benefit. The Commission believed that the head of the agency may wish to pay particular attention to this section. Although, as in the case of the other agency employees, this person would be serving on the board in his state capacity, his position was somewhat unique by virtue of his authority over the entire agency. He had to be particularly wary of granting any unwarranted benefits to the corporation or any of its members.

It appeared that the ethics code would not forbid the employees of the agency from serving as officers and directors of the corporation. However, the Commission believed that this situation should be monitored and that the Commission should be informed if any questions pertaining to ethics arose in the future. This opinion did not preclude the Commission from examining ethical problems that may develop in the future. The Commission also recommended that the agency consult with the Attorney General's office about the establishment of the corporation. The Commission thanked the employee for soliciting advice in this matter.

Dated: Honolulu, Hawaii, March 16, 1994.

STATE ETHICS COMMISSION  
Rev. David K. Kaupu, Chairperson  
K. Koki Akamine, Vice Chairperson  
Sharon "Shay" Bintliff, Commissioner  
Don J. Daley, Commissioner

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