

ADVISORY OPINION NO. 2019-4

July 18, 2019

The chair of the governing board of a state agency that regulates a particular industry sought guidance from the State Ethics Commission (“Commission”) on behalf of an agency employee. The chair asked whether the employee could take action on matters involving a company within the industry regulated by the agency (hereinafter, “Company A”) and Company A’s subsidiaries (hereinafter, “Company B” and “Company C”). The employee’s spouse is employed by Company A. For reasons discussed below, it is the Commission’s opinion that, because of the spouse’s employment with Company A, the Conflicts of Interests section of the State Ethics Code, Chapter 84, Hawai’i Revised Statutes (“HRS”), prohibits the employee from taking action on matters affecting Company A, Company B, and Company C.

I. FACTS

The employee’s agency is governed by a board that regulates companies within an industry. Companies seeking action by the agency file applications with the agency, which applications are then reviewed and analyzed by a team of agency staff. Team members represent different subject matter sections within the agency and are assigned to review different portions of the case before the agency. After reviewing a case, a team member typically writes a memo summarizing the topic; the team member might also make a recommendation regarding the topic. This memorandum and/or recommendation is then reviewed by the team member’s section chief and the team leader. The entire team may also discuss the case before presenting the matter to the agency’s board for the board’s review. The agency board has final decision-making authority on all cases.

The employee regularly participates in these team reviews, but the employee has not participated in the reviews of any applications filed by Companies A, B, or C. The employee’s spouse works for Company A, a company that is regulated by the agency and regularly submits applications to the agency. Companies B and C are wholly owned subsidiaries of Company A. Company A, in turn, is a wholly owned subsidiary of another company within the industry regulated by the agency (hereinafter, “Company D”). The employee likewise did not participate in the reviews of any applications filed by Company D. Companies A, B, and C have officers in common. An office within Company A appears to manage and coordinate the agency application filings of Companies A, B, and C.

II. APPLICATION OF THE ETHICS CODE

A. Conflicts of Interests: Action Affecting Company A

Two sections of the Ethics Code apply to this situation. First, the Conflicts of Interests law, HRS § 84-14(a), reads in pertinent part:

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

(1) A business or other undertaking in which the employee has a substantial financial interest. . .

The term “official action” is defined in HRS §84-3 as:

§84-3 Definitions. "Official act" or "official action" means a decision, recommendation, approval, disapproval, or other action, including inaction, which involves the use of discretionary authority.

The term “financial interest” is defined in HRS § 84-3:

§84-3 Definitions. "Financial interest" means an interest held by an individual, the individual's spouse, or dependent children which is:

* * * *

(3) An employment, or prospective employment for which negotiations have begun.

(Emphasis added.)

HRS § 84-14(a) prohibits the employee from taking any discretionary action directly affecting a business that employs the state employee’s spouse. Accordingly, the law requires the employee’s recusal from taking any discretionary action directly affecting Company A.

The Commission recognizes that, in managing cases, the agency staff works as a team and no staff member has final, decision-making authority. This does not mean, however, that the employee does not take official action. The Ethics Code defines “official action” as any action involving discretionary authority. Stated differently, in this circumstance, it includes discretionary action involved in reviewing and analyzing a case and drafting a memo. Further, the definition of official action specifically includes making a recommendation. Recommendations carry weight, and whether an employee has final decision-making authority on a matter is not determinative as to whether the employee is taking official action; if an employee takes any discretionary action on a company’s case, then the employee is taking official action directly affecting the company and is subject to the restrictions of HRS § 84-14(a).

B. Conflicts of Interests: Action Affecting Company B and Company C

Company B and Company C are both wholly owned subsidiaries of Company A, and Company A is a wholly owned subsidiary of Company D. The Commission construes the Conflicts of Interests law as prohibiting a state employee from taking discretionary action directly affecting a company in which the employee has a financial interest as well as any parent, subsidiary, or “sibling” of that company.

In Advisory Opinion No. 434 (1981), the Commission considered the situation in which a commissioner who was privately employed by a subsidiary company sought advice as to whether he could take action on an application submitted by the parent company. In advising that HRS § 84-14(a) prohibited this, the Commission opined:

When applying the standards set out in the ethics code in the past, this Commission has been guided by its mandate to liberally construe the code to promote high standards of ethical conduct in state government. We noted that while a parent company and its subsidiaries may have been separate legal entities, in fact, the benefits gained by or through its subsidiaries ultimately flowed to the parent company. As a consequence, this Commission concluded that, for purposes of the ethics code, the interests of the two corporations were identical, and thus the commissioner was prohibited from taking action in this matter.

Advisory Opinion No. 434, page 1.

The Commission expanded on its rationale in Advisory Opinion No. 544 (1984). In that case, a member of a board asked for advice as to whether he could take action on a petition submitted by corporation B, a wholly owned subsidiary of corporation C. The board member was privately employed by corporation A, which was also a wholly owned subsidiary of corporation C. The Commission advised that HRS § 84-14(a)

prohibited the board member from acting on the application from corporation B. In so doing, the Commission stated:

In past Commission opinions, such as Advisory Opinion No. 434, the Commission had concluded that for purposes of the ethics code the interests of a subsidiary and its parent company were identical. The Commission had noted that while a parent company and its subsidiary may be separate legal entities, the benefits gained by a subsidiary ultimately flow to the parent company. Accordingly, the Commission had determined that employees must disqualify themselves from taking action that directly affects their employers’ parent companies.

The board member's situation involved a “brother-sister” relationship between his employer, corporation A, and the petitioning corporation B. After reviewing the board member's circumstances, the Commission decided to reaffirm its conclusion that the interests of parent

companies and their subsidiaries are essentially the same because there is no limit to the flow of benefits from one to the other. Although the Commission's past opinions had focused on the flow of benefits gained by a subsidiary to its parent company, the Commission noted that the flow is bidirectional, and benefits gained by a parent company through its own business or from other subsidiaries may be channeled to any subsidiary as needed. The Commission noted that regardless of the source of funds, profits may be transmitted from the parent company to the subsidiaries in a number of ways such as in the form of capital, compensation for corporate officers, and profit-sharing. As a result, the Commission believed that a close relationship exists between parents and subsidiaries and subsidiaries with a common parent company. The Commission therefore concluded that employees who are employed by a subsidiary of a parent company must disqualify themselves from taking action in their state capacity that directly affects another subsidiary of that parent company.

Advisory Opinion No. 544, page 1.

More recently, the Commission issued a Resolution of Charge document affirming that parent and subsidiary companies are essentially considered single entities for purposes of the Conflicts of Interests law: Resolution of Charge No. 2016-3 considered a case in which an employee, through stock ownership, had a substantial financial interest in a company; the Commission stated that the employee should not have taken official action affecting the company's subsidiary.

The Commission further notes that, in this case, the parent and subsidiary companies do not appear to act independently of each other. Their officers overlap, and Company A appears to manage and coordinate applications submitted to the agency by Companies B and C. Accordingly, and consistent with its precedent, the Commission construes HRS § 84-14(a) as prohibiting the employee from taking official action affecting Companies A, B, C, and D.

The Commission recognizes that the employee is experienced in a certain subject matter and that the employee's recusal from matters affecting these companies may have an impact on the operations of the agency. The Conflicts of Interests law, however, is very clear: it requires recusal from taking discretionary action affecting the spouse's employer. It does not matter that the employee is not the final decision-maker, or that others also take discretionary action. The Ethics Code prohibits the employee from taking action on a case affecting any of these companies.

C. Fair Treatment

The second applicable provision of the State Ethics Code, HRS § 84-13(a), the Fair Treatment law, reads in relevant part:

§84-13 Fair treatment. (a) 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. . . .

The Fair Treatment law prohibits the employee from using the employee's position with the agency to grant any favoritism or unwarranted benefit to any of the companies, the spouse or anyone else. There is no indication that the employee had done this. However, the possible appearance of favoritism here would warrant the employee's recusal from these matters even if it were not required by the Conflicts of Interests law.

III. CONCLUSION

The Conflicts of Interests law prohibits the employee from taking official action affecting Companies A, B, C, and D. This includes any use of discretionary authority in reviewing, commenting on, or making recommendations regarding any of their cases before the agency. The Commission recognizes that its conclusion limits the employee's effectiveness and may impact the operations of the agency. Nonetheless, the Commission is bound by the clear mandate set forth in HRS § 84-14(a).

The Commission thanks the employee for seeking advice on this matter and commends the employee and the chair of the agency board for their sensitivity to ethical considerations.

Dated: Honolulu, Hawaii, July 18, 2019.

HAWAII STATE ETHICS COMMISSION

Reynard D. Gaulty, Chair
Ruth D. Tschumy, Vice Chair
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Melinda S. Wood, Commissioner
Wesley F. Fong, Commissioner