



# HAWAII STATE ETHICS COMMISSION

State of Hawai'i · Bishop Square, 1001 Bishop Street, ASB Tower 970 · Honolulu, Hawai'i 96813

## ADVISORY OPINION NO. 2019-6

September 6, 2019

A state agency (“Agency”) requested an Advisory Opinion from the Hawai'i State Ethics Commission (“Commission”) as to whether the State Ethics Code, Hawai'i Revised Statutes (“HRS”) Chapter 84, permits the Agency's award of a state benefit to a Private Company (“Company”), given that the Company's Chief Executive Officer (“CEO”) is a member of the Agency's Board of Directors (the “Board”). (The CEO is hereinafter referred to as “the Board Member.”) As discussed below, the Commission believes that the Agency is not prohibited from awarding the benefit to the Company. However, the Commission cautions the Agency that: (1) given the potential overlap between Board members' private business interests and state positions, Board members must take care to avoid violating the Conflicts of Interests law; (2) Board members and staff must not give Board members or their businesses preferential treatment, and should avoid any conduct creating the appearance of preferential treatment, so as to avoid any violation of the Fair Treatment law; and (3) Board members and staff should identify potential conflicts of interests as early as possible and seek guidance from the Commission as appropriate.

### I. Facts

#### A. The Board Member's Private Employment by the Company

The Company, a for-profit corporation, is a holding company for several other businesses. The Board Member became the CEO of the Company many years ago and remains employed in that capacity today. The Board Member works part-time – approximately twenty hours a week – as CEO and is also currently listed as an officer and director of the Company. In those capacities, the Board Member formulates the long-term strategic vision of the Company and its affiliated businesses, but does not manage the Company's day-to-day operations. Those duties are left to the Company's President. The Board Member is also the CEO and President of one of the Company's affiliated businesses and has leadership positions with the Company's other affiliated businesses, but does not manage the day-to-day operations of those businesses.

#### B. The Agency and the Benefit Program

The Agency is governed by a volunteer Board, whose members (including the Board Member) must have proven expertise in relevant fields.

The Agency recently launched the Benefit Program (“Program”), which was established by statute, and thereafter promulgated administrative rules. The purpose of the Program is to promote particular industries in Hawai‘i, and to expand and diversify Hawaii’s economy, by promoting business development. Businesses that qualify for the benefits are eligible to receive awards up to a certain maximum amount per year. Benefit applications to the Agency are initially reviewed and evaluated by a subcommittee of the Agency’s Board (“Committee”), which evaluates and scores the applications and recommends awards to the full Board. The Board then votes on whether to accept the Committee’s recommendations.

Once a benefit is approved, the Agency and the awardee enter into a memorandum of agreement setting out the terms of the benefit and any applicable milestones or progress payments. The Director of the Agency negotiates these contracts, formulates the milestones, and otherwise handles the day-to-day interactions between the Agency and the awardee. The Board would not otherwise be involved in an approved benefit unless a default occurred and the Agency had to initiate collection proceedings. According to the Agency’s Director, this is unlikely.

C. The Board Member’s Appointment to the Board and the Company’s Benefit Application

The Board Member was recently appointed to the Agency’s Board; by the time the Board Member joined the Board, the Legislature had already statutorily established the Program and the Agency was working to promulgate administrative rules for the Program. The administrative rules were drafted by the Agency’s staff with input from the Department of the Attorney General and other state agencies. The Board Member did not participate in drafting the administrative rules, nor did the Board Member engage in substantive discussions of those rules. However, the Board Member did vote to: (1) approve the draft administrative rules; and (2) delete a provision of the draft rules regarding a different state benefit. The administrative rules were adopted in 2019.

After the administrative rules were adopted, the Agency accepted benefit applications. Unbeknownst to the Board Member, the Company submitted a benefit application to the Agency. The Company’s application was submitted under the direction of its President, who learned of the Program in 2019 in an email that the Board Member received from a business association. The Company’s President consulted with its Controller and other individuals before deciding to apply for a benefit. The President has stated that he did not discuss the Company’s application with the Board Member because he (the President) recognized the need to “keep things independent” due to the Board Member’s role with the Agency. It is undisputed that the Board Member had no knowledge of the application or involvement in preparing it, nor did the Board Member ever speak to Company personnel about the Program until after the Agency had contacted the Commission for guidance in July 2019.

The Agency’s Committee reviewed and scored the applications, including the Company’s application, based upon criteria set forth in its statutes and administrative

rules. Applicants were scored on four categories, worth up to five points each, for a total of up to 20 points per applicant; the Committee gave each score a weighted average, applying a formula to ensure that each Committee member's score carried equal weight (and that one Committee member's aberrant high (or low) score would not make or break an applicant). The Board Member was not a member of the Committee and had no involvement in the Committee's review of benefit applications.

The Company's application included an executive summary which described the Company and its affiliated businesses and identified the Board Member as the founder of one of the businesses. Although Agency Board members and staff were already aware of the Board Member's position as the CEO of the Company and one of its associated businesses, there is no evidence that this resulted in more favorable treatment for the Company's application. Agency staff stated that the Board Member's ties to the Company and its associated businesses were never discussed during the review of the Company's benefit application by the Committee or the Board.

At a Board meeting in 2019, the Committee presented its scores and recommendations to the Board. The Company was one of two applicants recommended by the Committee to receive 100% of the benefit authorized under the Program. The Agency's administrative rules provide that in determining the distribution of the benefits, preference is given to businesses that agree not to claim another state benefit for similar activities. The Agency's benefit application form disclosed this information to applicants and asked applicants to "respond accordingly." The Company and one other applicant received the highest scores by the Committee; these two applicants were also the only two applicants (out of a total of seven applicants) that agreed not to claim the separate state benefit. Accordingly, the Committee recommended that the Company and the other applicant be awarded 100% of the benefit funding allowed them under the Program.

The Agency's Board approved the Committee's recommendations at its June 2019 meeting and the Company was awarded a benefit in excess of \$100,000. The Board Member, who was out of the country and did not attend the Board's June 2019 meeting, was unaware that the Agency had awarded a benefit to the Company.

In early July 2019, the deputy attorney general for the agency contacted the Commission's staff for guidance as to whether the Agency's award of the benefit to the Company was prohibited by the State Ethics Code. The Board Member first became aware of this matter in July 2019 when the Agency's Director informed the Board Member of the Company's benefit application and the ethics questions raised by the Agency's award to the Company.

## **II. Application of the State Ethics Code**

The State Ethics Code arises from Article XIV of the State Constitution, which states: "The people of Hawaii believe that public officers and employees must exhibit the highest standards of ethical conduct and that these standards come from the

personal integrity of each individual in government.” The Commission is charged with administering the State Ethics Code “so that public confidence in public servants will be preserved.”<sup>1</sup> To this end, the Legislature directs that the State Ethics Code “shall be liberally construed to promote high standards of ethical conduct in state government.”<sup>2</sup> The requirements of the State Ethics Code apply to all Agency Board members, including the Board Member, and to all Agency employees.<sup>3</sup>

As discussed herein, the State Ethics Code does not prohibit the Agency from awarding the benefit to the Company under the specific facts and circumstances of this case. In reaching this conclusion, the Commission considered the following applicable provisions of the Ethics Code: the Conflicts of Interests law (HRS § 84-14), the Contracts law (HRS § 84-15), and the Fair Treatment law (HRS § 84-13).

A. Conflicts of Interests Law: HRS § 84-14(a)

The Conflicts of Interests law, HRS § 84-14(a),<sup>4</sup> prohibits employees, including members of state boards and commissions, from taking official action directly affecting any business in which the board member has a substantial financial interest. The Board Member has substantial financial interests in both the Company and its associated businesses by virtue of the Board Member’s employment as the CEO and the Board Member’s director/officer positions in those businesses; therefore, the Board Member may not take any official action on behalf of the Agency “directly affecting” either the Company or its associated businesses.<sup>5</sup> “Official action” means a decision, recommendation, approval, disapproval, or any other action which involves the exercise of discretionary authority.<sup>6</sup> The Board Member has not taken any action that is prohibited by HRS § 84-14(a) because: (1) the Board Member was not a member of the Committee which evaluated benefit applications and recommended awards; (2) the Board Member did not attend the June 2019 meeting at which the Board approved the recommended benefit awards; and (3) the Board Member did not otherwise take any official action as an Agency Board member affecting the Company’s benefit application or any of the other applications.

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<sup>1</sup> HRS chapter 84, Preamble.

<sup>2</sup> HRS § 84-1.

<sup>3</sup> See HRS § 84-2 (“This chapter shall apply to every nominated, appointed, or elected officer, employee, and candidate to elected office of the State and for election to the constitutional convention . . .”). The Ethics Code defines an “employee” to include members of state boards, commissions, and committees. HRS § 84-3.

<sup>4</sup> HRS § 84-14(a)(1) states: “(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 . . . .”

<sup>5</sup> HRS § 84-3 defines a “financial interest” as including an “employment, or prospective employment for which negotiations have begun,” as well as “a directorship or officership in a business.”

<sup>6</sup> HRS § 84-3.

The Board Member did vote to approve the draft administrative rules for the Program and to delete a provision in the draft rules. However, the Board Member's actions on those dates occurred before the Company's President learned of the Program and decided to submit a benefit application to the Agency. At the time that the Board Member voted on the draft rules, the Board Member had no knowledge that the Company would later become an applicant; the Commission does not believe that the Board Member's actions with respect to the administrative rules on two occasions in 2018 and 2019 "directly affected" the Company. See Advisory Opinion No. 2012-1, 2012 WL 12973085, at \*2 (defining the term "directly affecting" as "without any intervening agency or instrumentality or determining influence") (quoting Tangen v. State Ethics Comm'n, 57 Haw. 87, 89, 550 P.2d 1275, 1277 (1976)).

B. Conflicts of Interests Law: HRS § 84-14(d)

HRS § 84-14(d), another section of the Conflicts of Interests law, prohibits a board member from being paid to assist or represent another person or business in transactions or proposals before the member's state agency.<sup>7</sup> This provision prohibits the Board Member from assisting or representing the Company (the Board Member's private employer) in any transaction or proposal before the Agency. For example, the Board Member would be prohibited from assisting the Company in submitting a benefit application to the Agency or contacting the Agency on behalf of the Company to discuss an application. However, there is no information indicating that the Board Member assisted or represented the Company in connection with its benefit application. The application designated the Company's President as its authorized representative and another Company employee as the contact person for the application. The Board Member had no involvement in preparing the application, was unaware that the Company had even applied for the benefit, and had no discussions or other communications about the application with the Agency Board or staff. Therefore, the Board Member's actions do not raise concerns under HRS § 84-14(d). However, the Board Member is still prohibited from assisting or representing the Company with the benefit in any manner before the Agency.<sup>8</sup>

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<sup>7</sup> HRS § 84-14(d) provides:

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 the legislator or employee has participated or will participate as a legislator or employee, nor shall the legislator or employee 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 the legislator or employee is an employee or legislator.

(Emphasis added.)

<sup>8</sup> The Company's President indicated that other employees will handle the negotiation of the memorandum of understanding with the Agency and other matters pertaining to the benefit.

C. Contracts Law: HRS § 84-15(b)

HRS § 84-15(b) prohibits a state agency from entering into any contract with a 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.” As previously discussed, the Board Member did not represent or assist the Company with its benefit application to the Agency. Had the Board Member done so, the Commission believes that the Agency may have been prohibited from awarding the benefit to the Company due to the Board Member’s participation in the Board vote approving the administrative rules for the award of benefits. However, there is no information indicating that the Board Member represented or assisted the Company in any manner with its application or that the Board Member even knew of the Company’s application until being informed of the application by the Agency’s Director in July 2019. Therefore, HRS § 84-15(b) does not prohibit the Agency from awarding the benefit to the Company or entering into a memorandum of agreement with the Company setting out the terms of the benefit.

D. Fair Treatment Law: HRS § 84-13

The Fair Treatment Law, HRS § 84-13(a), prohibits state board members and employees from using their state positions to obtain unwarranted advantages or benefits for themselves or others.<sup>9</sup> This section of the State Ethics Code prohibits the Board Member from using the position as a Board member to obtain preferential treatment for the Company. This section also prohibits other Board members and Agency staff from granting any preferential treatment to the Company or any other business.

The Commission has no information indicating that the Board Member at any time used or attempted to use the position as a Board member to obtain preferential treatment for the Company. Nor does the Commission have any information indicating that other Board members or Agency staff gave or attempted to give any preferential treatment to the Company due to the Board Member’s state position. Thus, it does not appear that any Agency Board member or staff violated the Fair Treatment law during the Agency’s consideration and approval of the Company’s benefit application.

Nevertheless, the Agency’s consideration of a benefit application from a business controlled by one of its own Board members raises serious concerns under the Fair Treatment law: Agency Board members – and particularly staff – may have felt pressure to treat the Company’s application more favorably, and the public may

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<sup>9</sup> HRS § 84-13(a) states that: “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 . . . .”

perceive that the Company received more favorable treatment (even if such preferential treatment did not actually occur).

The following illustrates how an appearance of preferential treatment could easily arise. The Commission was informed that, after the Program was established by statute, an Agency employee told Board members in open session that the Program would be a good opportunity for businesses and that “hopefully their companies would apply.” The employee indicated that his comment was meant to assist the Program in obtaining as many applications as possible. However, it could have been perceived that preferential treatment would be given to Board members’ companies even though the comment was not intended to suggest this.<sup>10</sup>

The Commission has raised similar concerns in other cases. For example, in Advisory Opinion No. 2017-3, the Commission held that the Fair Treatment law prohibited a state board member from applying to her own board for a government endorsement even if she disqualified herself from the board’s decision-making. The Commission noted that the board member could receive preferential treatment because she “has had (and will continue to have) opportunities to build and foster relationships with her fellow Board members through her ongoing interactions with them” and that such “relationships may place the Board Member in a more advantageous position with regard to [the] Board’s decision on whether to approve her application.” Id. at 4. Additionally, from the public’s perspective, “having a current Board member’s application granted by the Board (even though the member was disqualified from the decision making) raises, at the very least, an appearance of impropriety as to the fairness of the process.” Id. at 5. The Commission held that these concerns barred the board member from applying for the endorsement herself or having another person apply on her behalf.

This case may appear to present similar concerns because other Agency Board members and staff knew that the Board Member was the CEO of the Company and one of its affiliated businesses, which could lead to a similar “appearance of impropriety” as to the fairness of the Agency’s benefit approval process. The Commission believes, however, that there are critical differences between Advisory Opinion No. 2017-3 and this case.

In Advisory Opinion No. 2017-3, the board member sought her own board’s approval for a government endorsement from which she would personally benefit. In order to obtain the endorsement, the board member sought to apply to the board herself or arrange for someone else to apply on her behalf. In this case, the Board Member did not seek approval from the Board Member’s own board for any personal or Company benefits, nor did the Board Member arrange for anyone else to act on the Board Member’s behalf in seeking approval from the Board for any benefits. The Board Member had no involvement in the Company’s decision to apply for the benefit and did

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<sup>10</sup> Aside from the Company, no other businesses employing Agency Board members applied for a benefit from the Agency.

not participate in the preparation or submission of the Company's application to the Agency. In fact, the Board Member was not even aware that the Company had submitted a benefit application or that the Board had approved the award of the benefit to the Company until after being informed of such by the Agency's Director.

The Commission recognizes that this is a close case. In light of the facts presented, however, the Commission concludes that the Agency may proceed with the award of the benefit to the Company based on the following considerations: the Board Member did not assist or represent the Company in any way in its benefit application to the Agency, nor was the Board Member involved in any Agency action as a Board member affecting the Company's application, thus avoiding any concerns under the Conflicts of Interests law. The fact that the Board Member did not assist or represent the Company in applying for a benefit from the Agency also avoids concerns under the Contracts law. And finally, there is no indication that the Company received any unwarranted or preferential treatment from Agency Board members or staff because of the Board Member's state position, thereby addressing the Commission's concerns under the Fair Treatment law.

Given the concerns identified above, the Commission urges Board members and Agency staff to avoid creating even the appearance of preferential treatment, identify potential conflicts of interests as early as possible, and seek guidance from the Commission as appropriate. Doing so avoids the risk of a Board member or Agency staff member inadvertently violating the State Ethics Code.

### **III. Conclusion**

For the reasons discussed above, the Commission believes that the State Ethics Code does not prohibit the Agency from awarding the benefit to the Company. The Commission thanks the Agency for seeking guidance, through its counsel, on this issue; it likewise thanks the Board Member and the employees of the Company for their cooperation.

Dated: Honolulu, Hawaii, September 6, 2019.

#### **HAWAII STATE ETHICS COMMISSION**

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