

INFORMAL ADVISORY OPINION NO. 23

On August 4, 1980, two individuals filed charges against state officials alleging a conspiracy to protect a private business which was subject to state regulation and licensing. The officials were given an opportunity to and did appear at a Commission hearing to respond to the charges.

The pertinent section of the ethics code was the fair treatment section, HRS §84-13. The opening paragraph of that section provides as follows:

No legislator or employee shall use or attempt to use his official position to secure or grant unwarranted privileges, exemptions, advantages, contracts, or treatment, for himself or others

In essence, the fair treatment section provides that state officials may not use their positions to grant unwarranted advantages to themselves or others, whether or not it can be shown that they themselves receive any compensation or reward for such use of position. In the Commission's view, the term "unwarranted," while not defined in the statute, means that a state employee or official has attempted to secure an advantage for another person or business that would not come about through the proper exercise of state powers. In this case, the complainants alleged that the state officials had failed to properly investigate allegations of misconduct on the part of the private business. It was their view that this failure to investigate was an act intended to protect the licensee.

The complainants identified a number of business procedures that appeared to be out of the ordinary. The Commission had to decide, first, the evidence indicated an intent to protect the licensee or, second, the procedures followed by the licensee were so clearly improper that the failure of the officials to aggressively pursue an investigation of them must lead to the conclusion that the failure to take such action was intended to benefit the private business and disadvantage the complainants. A mere showing of incompetence or a lack of will to investigate a difficult case did not, in our view, constitute a violation of the fair treatment section.

The complainants had owned and operated a business in the State of Hawaii. The primary activity of this business was the wholesale preparation and distribution of certain items. The controversy in this case revolved around a contract the complainants had entered into to provide these items. The items were to have been imported from a foreign distributor. The licensee had agreed to hold and distribute funds that were intended to pass from the complainants to their distributor.

Eventually a dispute arose as to the handling of the funds; this led to the licensee loaning funds to the complainant. In order to document the amounts so advanced, the licensee and the complainants executed a note and security agreement. Ultimately, after the complainants were unable to repay the loan, the licensee seized the complainants' business effects and had them sold at an auction. Allegations of unsound procedures on the part of the licensee concerned the note and security agreement and certain other transactions and incidents that followed.

We listed the allegations of unsound business procedures made by the complainants.

- (1) On a specific date, the complainants executed a note agreement with the licensee; in the column reserved for the identification of collateral was entered the term "None;" sometime thereafter, the note was altered such that the word "None" was crossed out and the term "UCC-1" inserted in its place. The complainants alleged that they did not sign this alteration and were not notified of it.
- (2) A security agreement was executed in consideration of an indebtedness of nearly \$20,000. An entry on the agreement makes reference to a document dated ten days *after* the signing of the security agreement, but the reference was not initialed by the debtors.
- (3) A letter was prepared by the licensee notifying the complainants of an auction of their business equipment to be held four days after the date of the letter. However, the date on the envelope was two days before the day scheduled for the auction. The complainants stated that they could not, therefore, have received the letter more than one day before the auction was held. They alleged that this was unreasonably short notice of the auction.
- (4) The complainants were notified by the licensee that they would be charged 35 percent of the amount realized from the auction as the auctioneer's fee. This amount was in excess of the fee established by law. The complainants maintained further that they had never been presented with a complete accounting of the auction itself and that the accounting that was made available was prepared several weeks after the auction by an individual who was not present at the auction.
- (5) The complainants stated that the signature cards bearing the signatures of one of the complainants as an officer of their business appeared to have been altered; the signatures did not appear to be that of the complainant. In one instance, the name was actually misspelled.
- (6) The complainants alleged that a UCC-1 financing statement was made and filed by the licensee without their knowledge. They further alleged that the financing statement was compiled from a listing of the inventory located on their business premises that was intended for fire insurance purposes and was not to be included in a financing statement. They alleged that they signed the first page of the financing statement in blank and that the second page did not bear their signatures and appeared quite different in form from the first page.

The Commission's staff discussed this matter with the state employee who had been assigned by the officials to investigate the complainants' allegations. The Commission also reviewed his investigation report. The investigation seemed to be incomplete and did not pursue those questions that could not be immediately resolved.

The officials themselves presented a number of arguments, the major ones of which were as follows:

- (1) The complainants' presentation to them was disjointed and did not give a complete picture of all of their complaints. Therefore, while some of their allegations appeared serious, in retrospect, the initial questions raised did not appear to

seriously question the integrity of the licensee's practices but merely evidenced confusion over the balancing of accounts.

- (2) The controversy between the complainants and the licensee had gone into litigation. It was the department's view that, generally speaking, it would not intervene or proceed to investigate matters that were in litigation.
- (3) The officials agreed that certain of the procedures followed by the licensee were questionable but that they were not serious errors and did not jeopardize the complainants' position. A fundamental question in the matter was whether the complainants understood that the assets of their business would be pledged to secure their debt to the licensee. The officials stated that it was their belief that the complainants were well aware of this fact and, while appropriate formal notice had not been given to them of the actions taken by the licensee, they were not hurt by such failure because they were fully aware that the full inventory of the business would be pledged to secure the loan. No other evidence was presented to substantiate this conclusion.
- (4) The officials maintained that, while their office did attempt to resolve disputes between customers and licensees, the office did not have the authority to order restitution to a customer.

As we had indicated, the officials did undertake an investigation of the allegations made. We also noted that another state office had investigated the handling of this matter by these officials and had expressed concern over the manner in which it had been processed.

One official was primarily responsible for the investigation. He was unable to provide answers to most of the questions put to him concerning the several procedures enumerated above. While he had presented to the Commission copies of letters to the licensee indicating his concern about some of its procedures, there did not appear to have been any follow-up by him. The officials had determined that they should take no further action while the matter was in litigation. However, they presented no legal authority on which to base their judgment that the investigation should not proceed to a conclusion. They also stated that they had not attended the trial and did not know if the court had heard evidence concerning the issues raised in the complaints filed with their office.

The allegations enumerated above appeared to call for a more aggressive response than was seen in the officials' position in this matter. The complainants had alleged that the licensee altered a note; altered signature cards and affixed unauthorized signatures to them; charged a fee for the holding of the auction that was in excess of that set by statute and failed to provide an accurate accounting of the auction itself; failed to provide reasonable notice to the complainants of the holding of the auction; persuaded them to sign the agreement, the note, the financing statement, and other documents in blank; and completed the documents in a manner not consistent with the understanding of the parties.

It was the position of the Commission, after our review of the investigation, that the following questions remained unresolved:

- (1) Had the note and security agreement been altered, and, if so, what were the circumstances that led to the alteration?
- (2) What were the circumstances that surrounded the preparation of the UCC-1 financing statement?
- (3) Was the fee assessed to the complainants for the holding of the auction in excess of that authorized by statute; if so, had this been a practice that had been followed regularly by this and other licensees?
- (4) Had there been a failure on the part of the licensee to provide a full accounting of the auction and an explanation as to the location of items that were not sold?
- (5) and (6) Additional questions concerning the authenticity of the signatures of the complainants on certain documents.

We concluded that the apparent failure of the officials charged in this case to pursue a complete investigation of these questions in an effective manner was not evidence of an intention on their part to aid the licensee to the disadvantage of the complainants. The evidence presented did not lay a basis for finding that the officials had acted in collusion with the licensee or others. Therefore, we did not find a violation of HRS §84-13.

We stated that because the failure of officials exercising regulatory responsibilities to take positive action in a matter involving serious allegations of misconduct created an appearance that the regulating agency was protecting the business to the disadvantage of the consumer, we believed that the concerns expressed herein should cause the officials to more critically evaluate this matter. In this case, we felt that the agency officials had sufficient statutory authority to pursue answers to the questions raised. We noted that another state agency had also been dissatisfied with the explanations that had been given by the officials.

Dated: Honolulu, Hawaii, December 5, 1980.

STATE ETHICS COMMISSION
Edith K. Kleinjans, Chairman
Gary B.K.T. Lee, Commissioner
Robert N. Mitcham, Commissioner

Note: Vice Chairman Paul C.T. Loo and Commissioner Dorothy K. Ching disqualified themselves from consideration and preparation of this opinion.