

MEMORANDUM

State of Alaska Department of Law

TO: The Honorable Bruce M. Botelho
Attorney General

DATE: September 23, 1999

FILE: 663-99-0232

TEL NO.: 465-3600

SUBJECT: Service on a State Board
That Awards Grants

FROM: Philip A. Reeves
Assistant Attorney General

You have requested advice regarding the application of the Alaska Executive Branch Ethics Act (Ethics Act) to a potential conflict of interest of a member of the Alaska State Council on the Arts (Council) arising from the member's ownership interest in a commercial business that sells bulk mail services to certain non-profit arts organizations that receive state grant funds awarded by the Council. We first find that the Council member's indirect financial interests in commingled grant funds, which arise from minor commercial transactions between the member's business and grant recipients, do not implicate the prohibitions of AS 39.52.150. The Council member is therefore not denied the opportunity to serve on the Council.

From the experience of the FY 1999 grant process and the facts presented in this investigation, it appears likely that continued service by the Council member in question will face the Council with numerous decisions on the application of AS 39.52.120 as a part of each annual grant process. Through this opinion we intend to provide a framework for the member and the Council to use in making the individual determinations of prohibited conflicts on a case-by-case basis. If the Council determines that a violation of AS 39.52.120 would occur through the member's participation in any individual grant matter, the member may avoid or cure that conflict by abstaining from participation in that matter while otherwise continuing to serve on the Council.

BACKGROUND

The Alaska State Council on the Arts is a public authority established by statute in the Department of Education and Early Development. Members of the Council are therefore "public officers" subject to the Alaska Executive Branch Ethics Act (Ethics

Act). Among the powers and duties of the Council is the authority to award grant funds to organizations involved in the study and presentation of the performing, visual, and fine arts. The grant program provides two categories of grants: (1) operations grants, which provide funding to the general operating budget of the recipient organization; and, (2) project grants, which are limited for expenditure to a particular project. Neither category of grants provides any restrictions or conditions regarding specific expenses or even classes of expenditures to be paid from the grant funds. As far as the grant conditions are concerned, the grant funds are simply commingled with the rest of the operational or project funds of the grant recipient organization (GRO).

Nothing in the grant process requirements solicit from the GRO any documentation that would identify or designate a list of specific vendors with whom the GRO typically does business; i.e., to whom commingled operation funds will be paid. The budget forms which the grant process requires do not provide detail to a level that identifies specific small categories of expenditures, such as the bulk mailing expenses subject of this opinion. Such small expenditures are contained within the much broader budget categories of "marketing" or "fundraising."

A. Potential conflict. Among the numerous categories of minor operating expenses incurred by the grant recipients are expenses for bulk mailing services. Council member X is a 50 percent owner of Z Company, a commercial archive storage and bulk mail preparation business that has provided bulk mail services to several of the grant recipient organizations in past years including nine GROs during state FY99. Z Company does not enter into term contracts with any of the GROs -- business is transacted over the counter on a job-by-job basis.

B. Magnitude of X's financial interest. Z Company provided services to nine GROs during FY99. Seven of those organizations received operations grants and two received project grants. In each case the grant funds were commingled with the overall operations budget or project budget. As shown in Table A (attached) the nine recipient organizations together received \$71,932 in Council-awarded grant funds. The grant funds constituted from 0.3 to 4.3 percent of the total operations or project budget of the individual GROs. Z Company received a total of \$42,954 for services provided to the nine GROs in FY99, and had gross revenues of over \$2 million. Z Company revenues from the GROs thus equaled approximately 2 percent of total annual revenues.

DISCUSSION

There are two separate provisions of the Ethics Act that might have application to the facts of this case. Under AS 39.52.120, a public officer, including a member of a board or commission, may not take official action that affects the officer's personal or financial interest. In general, an officer can avoid a violation of AS 39.52.120 by abstaining from participation in a particular matter in which the officer has a personal or financial interest. 1994 Inf. Op. Att'y Gen. (Nov. 29; 661-95-0214).

A second provision, AS 39.52.150(a), applies to any public officer who "may take or withhold official action that affects the award, execution, or administration of [the] state grant, contract, lease or loan." AS 39.52.150 applies regardless of whether the official actually takes any such official action and has uniformly been interpreted to mean that a public officer cannot "cure" the conflict by abstaining from participation on the individual grant that creates the conflict. A member of a board or council with grant award authority may not hold a personal or financial interest in a state grant which the board or council awards; the member must either resign from the board or council or not apply for grant awarded by the board.¹ *See, e.g.*, 1997 Inf. Op. Att'y Gen. (May 30; 663-97-0400).

A. Improper influence in state grants. Looking first to the stricter prohibitions of AS 39.52.150 concerning improper influence on state grants, we must initially determine whether X's indirect receipt of state grant funds through the over-the-counter commercial transactions of his business with the GROs constitutes "a personal or financial interest in a state grant." A review of existing ethics opinions reveals a single case in which the issue of "indirect interest in a state grant" was considered. 1987 Inf. Op. Att'y Gen. (July 10; 663-87-0594). In that case, a board member whose board awarded operating grants to a public television station was a shareholder in a firm that rented office space to the television station. As here, the commingling of the grant funds with the general operations fund of the station made it impossible to find no connection between the grant funds and the lease. That opinion considered the threshold question of whether the firm's office rental contract was a "financial interest in a state grant" under the definition in AS 39.52.960(9)(A), and found:

Your firm does not have a "financial interest" in KXXX as the term is intended under the Act (e.g., interest in the ownership or involvement in KXXX's operations) merely because your firm has

¹ Subsection (b) of AS 39.52.150 contains some exceptions to the absolute prohibition in subsection (a), but those exceptions are not applicable to the facts of this case.

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a management contract allowing it to rent space in your building,

and KXXX is one of many renters. Therefore, further analysis of AS 39.52.150 is unnecessary.

Id. at 3-4.

While we concur with that result, we believe that some additional analysis may be helpful. First, it is important to note that AS 39.52.150 and AS 39.52.120 substantially overlap in regulating personal and financial conflicts of interest arising from state grants. Both sections seek to eliminate the opportunity for a board member to take or withhold official action concerning a state grant that would affect a matter in which the member has a personal or financial interest, but they approach that purpose in different ways. AS 39.52.120 addresses only the individual board action through which a board member might affect his interests, and it allows the member to serve on a board while avoiding particular individual conflicts by abstaining from board participation on a case-by-case basis. AS 39.52.150 seeks to avoid any possible appearance of impropriety by totally excluding an interested person from any service on the board, even where the matter with which the person has a conflict of interest represents a minor portion of the board's work. A determination that AS 39.52.150 applies only in cases where an officer has a direct interest in the grant recipient organization or a direct stake in the grant funds, and not in cases of indirect financial interests, would thus not leave those indirect interests unregulated by the Ethics Act. They would simply be subject to the case-by-case application of AS 39.52.120.

We believe that application of the far less onerous remedy of AS 39.52.120 to cases of indirect financial interests is more appropriate under the legislative guidance provided in AS 39.52.110. That section expresses the legislature's intent regarding the scope of application of the Ethics Act, stating:

the legislature finds that, so long as it does not interfere with the full and faithful discharge of an officer's public duties and responsibilities, this chapter does not prevent an officer from following other independent pursuits. The legislature further recognizes that

(1) in a representative democracy, the representatives are drawn from society and, therefore, cannot and should not be without personal and financial interests in the decisions and policies of government;

(2) people who serve as public officers retain their rights to

interests of a personal and financial nature; and

(3) standards of ethical conduct for members of the executive branch need to distinguish between those minor and inconsequential conflicts that are unavoidable in a free society, and those conflicts of interest that are substantial and material.

(b) Unethical conduct is prohibited, but there is no substantial impropriety if, as to a specific matter, a public officer's

(1) personal or financial interest in the matter is insignificant, or of a type that is possessed generally by the public or a large class of persons to which the public officer belongs; or

(2) action or influence would have insignificant or conjectural effect on the matter.

Applying this legislative intent, we believe that the severe remedy of total exclusion from public service of AS 39.52.150 must apply only to those substantial and material conflicts occasioned by an officer's direct interest in a grant which is administered by the officer's board. A "direct interest" would include either (1) direct employment or membership by the board member in the grant recipient organization or (2) direct reference in the grant documents or grant process to the board member's commercial enterprise to which grant funds will flow.²

Under the facts presented in this case, we find that the indirect interests of Z Company in the Arts Council grants, which arise from a number of relatively minor commercial transactions paid for from the commingled general funds of the grant recipients, are more reasonably dealt with on a case-by-case basis under the terms of AS 39.25.120 than under AS 39.52.150. We find that the legislature did not intend to exclude X and all like situated business owners from public service on boards, commissions, and councils based on such indirect interests in state grants.

B. Misuse of official position. AS 39.52.120 prohibits a public officer from taking or withholding official action in order to affect a matter in which the officer has a personal or financial interest. In this case Z Company receives payments for

² In reaching this conclusion -- that AS 39.52.150 applies only in the case of a *direct* financial interest in a state grant -- we find that the term "financial interest in a state grant" has a specialized meaning that is different and more narrow than the more open-ended phrase "personal or financial interest" used in AS 39.52.120.

commercial services transacted with several organizations that annually apply for grant funding from the Council. Mr. X and the Arts Council have suggested that (1) the small scope of the commercial transactions as a percentage of Z Company gross sales, and (2) the small proportion that the grant funds make up of the total operations funds of the GRO organizations with which they are commingled, together support a finding that these financial interests are "minor and inconsequential conflicts" which the legislature has placed outside of the scope of the Ethics Act through the express intent language of AS 39.52.110.

The scope limitations under AS 39.52.110 do offer a basis for finding that certain de minimis financial interests fall outside of the prohibitions of AS 39.52.120, but those determinations must be made on a case-by-case basis and not through a general analysis which blends the review of many separate individual "matters" into a single determination. In examining each financial interest the Council is *not* seeking to determine whether X's financial interest actually did affect his decisions in the grant process, but is rather asking whether a member of the public, who has no personal acquaintance with X or the recipient organizations, could *reasonably* suggest that the financial interests are of sufficient magnitude to affect a Council member's vote.

You have presented information on nine grants from the FY99 grant year in which X has some indirect financial interest by virtue of his commercial involvement with the GRO. The grant award process for each of those nine grants is a separate "matter" from which X must abstain unless the financial interest is determined to be "insignificant or conjectural." You must first determine whether X's financial interest (his commercial receipts) in a particular GRO is a significant financial interest. This determination should be made in the context of the size of X's business (\$2 million gross annual receipts) but must also take into account the gross dollar amount of the receipts from each individual GRO. For example, looking at the numbers provided for the nine GROs (Table A), we believe that the \$21,867 account with a single GRO, standing alone, would almost surely be found to be a significant financial interest, the accounts in the \$3000 - \$4000 range are likely to be significant, while the smaller accounts are less likely to be significant.

Where an account is determined to be significant financially, you must then determine whether the decision to award a grant to that GRO would significantly affect X's financial interest and whether such affects are likely or merely conjectural. *See, e.g.*, 1996 Inf. Op. Att'y Gen. (Jan 1; 661-95-0214) (If the Chair determines that a particular proposal would have an insignificant or conjectural effect on the Board member's

financial interests as a permit holder and fisher in the fishery, then the Board member should be allowed to participate.) The financial information and calculations which you have provided (assembled in Table A) provide a good deal of evidence that you may find relevant to your determination of the significance to X's commercial interests with the GROs of his participation in the grant process.

Each individual matter will potentially raise many additional factors for consideration. While we cannot possibly anticipate all such potential factors, two additional factors derived from the investigation of this case that may be relevant to the "likely vs. conjectural" determination (and that counterbalance each other) are:

(1) The nature of the contractual relationship. Here, X's business holds no term contracts with the GROs. Each individual purchase is at the sole discretion of the GRO on a per-job, walk-in basis. Charges are on the same terms and pricing structure as is applicable to all non-profit customers. This type of commercial relationship would tend to support a determination that any future transactions are conjectural.

(2) The history of former commercial relationships. Here, several of the GROs have stated their intention to continue using Z Company exclusively for bulk mail services, based upon their long experience of good service and pricing. In those cases it is therefore not mere conjecture to anticipate a continued financial interest by Z Company in the GROs.

C. Procedure for Council determinations. The Council anticipates that future grant years will present matters of potential conflicts similar to those of the FY99 grant process that will need to be addressed expeditiously in order that the processing and award of grants not be unduly delayed. We have therefore endeavored to provide an interpretation of the Ethics Act in a form that will provide you with a framework within which you can determine the presence or absence of a conflict requiring abstention by an individual council member. The Ethics Act provides for these determinations to be made directly by the Arts Council by the process set out in AS 39.52.220(a):

A member of a board or commission who is involved in a matter that may result in a violation of AS 39.52.110 -- 39.52.190 shall disclose the matter on the public record and in writing to the designated supervisor and the attorney general. The supervisor shall determine whether the member's involvement violates AS 39.52.110 -- 39.52.190 and shall provide a copy of the written

determination to the board or commission member and to the attorney general. If a member of the board or commission objects to the ruling of the supervisor, or if the supervisor discloses an involvement requiring a determination, the members present at a meeting, excluding the involved member, shall vote on the matter. If the supervisor or a majority of the members voting determine that a violation will exist if the member continues to participate, the member shall refrain from voting, deliberating, or participating in the matter.

Summary

First, we find that AS 39.52.150 applies only to direct financial or personal interests held by a board or council member in a grant that the board or council administers. We consider a direct interest to include either (1) direct employment or membership by the board member in the grant recipient organization or (2) direct reference in the grant documents or grant process to the board member's commercial enterprise to which grant funds will flow. We specifically find that AS 39.52.150 does not apply to the indirect financial interests of Council member X as presented in this case.

Moving to application of AS 39.52.120, this opinion attempts to provide a useful framework which the Council can apply in ruling on (1) the significance of a member's financial interests in individual commercial transactions between a member's business and a grant recipient organization, and (2) the significance of an individual grant award decision to those financial interests. It appears that X's financial interests with several of the nine identified FY99 grant recipients could be found to be significant financial interests. The Council has identified a substantial amount of statistical information that may establish the significance, or insignificance, of X's involvement in each of the individual grant matters which affect those significant financial interests. We have suggested some additional factors which may be relevant to this determination -- it is left to the Council to decide which factors are relevant and to then determine the significance of the conflicts in each individual matter.

Where the Council determines that a member has a significant indirect financial interest in a commercial relationship with a grant recipient, and further determines that a reasonable person could question whether that financial relationship might affect a Council member's vote in the grant process involving that recipient, then a significant conflict of interest must be found and that member must abstain from

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participation in that grant award process.

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