

## 2010 Legislative Update – Local Government Conflicts of Interest and Ethics

### Session Law 2010-169 (H961) – Gifts for Influencing the Award of Contracts

G.S. 14-234(a)(3) already prohibited any public officer or employee from receiving or asking for any gift, reward, or promise of reward in exchange for recommending, influencing, or attempting to influence the award of a contract by the public agency he or she serves. Section 2 of Session Law 2010-169, which goes into effect on December 1, 2010, adds favors, services, and promises of future employment to the list of items a public officer or employee may not receive or solicit.<sup>1</sup> Violations of G.S. 14-234 are a Class 1 misdemeanor, punishable by up to 120 days imprisonment and a fine.

### Session Law 2010-122 (H1717 / S1112) – ABC Board Ethics and Conflicts of Interest

Session Law 2010-122 makes some substantial changes to the conflict of interest statute that applies specifically to the ABC Commission and to local ABC boards, G.S. 18B-201, and adds a new section G.S. 18B-706, relating to codes of ethics and ethics training for ABC local boards.<sup>2</sup> To understand the complexity of these changes, it's important to first understand that local ABC board members were already covered by—and still are covered by—the conflict of interest statutes that apply to all public officials and employees in North Carolina: G.S. 14-234, G.S. 14-234.1, and G.S. 133-32. In fact, the amendments to G.S. 18B-201 reemphasize that G.S. 14-234 and G.S. 133-32 apply to ABC board members. However, while there is some overlap between G.S. 18B-201 and these two statutes, there are also some contradictions. This means that local ABC board members will need to be familiar with all of these statutes, and should consult with their attorney if they have questions about potential conflicts of interest. A summary of G.S. 14-234, G.S. 14-234.1, and G.S. 133-32 can be found at the end of this document.

#### Navigating the Conflicts of Interest Statutes That Apply to ABC Board Members

If a board member believes that a contemplated action—involving the member, the member's spouse, the member's relatives, or a business with which the member is associated (using the definition below)—may be unethical or may give rise to a conflict of interest, the member should take the following steps:

1. Determine whether the action violates G.S. 14-234, G.S. 14-234.1 or G.S. 133-32. If it does violate any of those statutes, the action should not be taken. If the action does not violate any of those statutes, continue to step two.
2. Determine whether the action violates G.S. 18B-201. If it does violate G.S. 18B-201, the action should not be taken. If it does not, continue to step three.
3. Determine whether the action is unethical, seeking guidance from trusted advisors if necessary. If the action is unethical, the action should not be taken. If the action is ethical, the board member (or spouse, relative, or business) may take the action.

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<sup>1</sup> The other sections of S.L. 2010-169 are addressed in the 2010 Ethics and Lobbying legislative update.

<sup>2</sup> S.L. 2010-122 also makes several other changes to the ABC statutes. The changes not related to ethics and conflicts of interest are discussed in more detail in the 2010 Alcoholic Beverage Control legislative update.

## Key Concepts and Definitions

1. "Related to the first degree by blood or marriage" means your spouse, your parents, your spouse's parents, your brothers/sisters, your spouse's brothers/sisters, and your children.
2. "Related ... by blood to a degree of first cousin or closer" means your spouse, your parents, your grandparents, your great-grandparents, your aunts/uncles, your great-aunts/uncles, your first cousins, your brothers/sisters, your nieces/nephews, your grand-nieces/nephews, your children, your grandchildren, and your great-grandchildren.
3. "Business with which associated" is defined as a business in which the person or any member of that person's immediate family<sup>3</sup> does any of the following: (a) is an employee; (b) holds a position as a director, officer, partner, proprietor, or member or manager of a limited liability company, irrespective of the amount of compensation received or the amount of the interest owned; (c) owns a legal, equitable, or beneficial interest of ten thousand dollars (\$10,000) or more in the business or five percent (5%) of the business, whichever is less, other than as a trustee on a deed of trust; or (d) is a lobbyist registered under Chapter 120C of the General Statutes.

Note that the term "business" does not include a widely held investment fund, including a mutual fund, regulated investment company, or pension or deferred compensation plan, if all of the following apply:

- (a) The covered person or a member of the covered person's immediate family neither exercises nor has the ability to exercise control over the financial interests held by the fund; and
- (b) The fund is publicly traded, or the fund's assets are widely diversified.

(from G.S. 138A-3(3)).

4. "Financial benefit" is defined as "a direct pecuniary [monetary] gain or loss, or a direct pecuniary loss to a business competitor." G.S. 18B-201(g). (Note that this is different from the definition of "direct benefit" found in G.S. 14-234, discussed below.)
5. The effective date of these amendments is October 1, 2010.

## Dealings with family members (G.S. 18B-201(c))

The session law extends the prohibition on benefitting from ABC Board contracts or other ABC business matters to the board members themselves as well as to the member's spouse and persons related to

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<sup>3</sup> "Immediate family" is defined as "[a]n unemancipated child of the covered person residing in the household and the covered person's spouse, if not legally separated. A member of a covered person's extended family shall also be considered a member of the immediate family if actually residing in the covered person's household." G.S. 138A-3(17). "Extended family" is defined as a person's "[s]pouse, lineal descendant [children, grandchildren, great-grandchildren, and so on], lineal ascendant [parent, grandparent, great-grandparent, and so on], sibling, spouse's lineal descendant, spouse's lineal ascendant, spouse's sibling, and the spouse of any of these individuals." G.S. 138A-3(13).

the member by blood to a degree of first cousin or closer. (The earlier version of the statute only prohibited the member's spouse or the member's relatives from benefitting from such contracts or business matters.) It also clarifies that the prohibition is on **financial** benefits (as defined above) from such contracts. G.S. 18B-201(c) is similar to G.S. 14-234, but is different in several significant ways, including the people covered by the statute (G.S. 14-234 does not cover the board member's relatives, just the member and his/her spouse), the type of benefit prohibited (compare the definition of financial benefit in G.S. 18B-201 with the definition of direct benefit in G.S. 14-234), and the exceptions to G.S. 14-234 (none of which are included in G.S. 18B-201).

#### Gifts and favors (G.S. 18B-201(d), (i))

Provides that G.S. 133-32 applies to the Commission and local ABC boards. (G.S. 133-32 actually already applies to all officers or employees involved in (1) preparing plans, specifications, or estimates for public contract; (2) awarding or administering public contracts; or (3) inspecting or supervising construction.) These new provision makes it unequivocally clear that local ABC boards are covered by G.S. 133-32, and that, if there is a conflict between the application of G.S. 18B-201 and G.S. 133-32, G.S. 133-32 controls.

#### Local Board Conflicts of Interest (G.S. 18B-201(f), (g), (h), (i), and (k))

General prohibition: A local ABC board member shall not knowingly use his or her position on the board in a way that will result in a financial benefit (as defined above) to:

- the ABC board member,
- the ABC board member's spouse,
- "any person related to the local ABC board member by blood to a degree of first cousin or closer" (see definition above), or
- "any business with which the local ABC board member is associated" (see definition above).

Exceptions:

The board member may participate in actions of the ABC local board even if such action would result in a financial benefit to the member (or his/her spouse, relative, or associated business) under any of the following exceptions:

- If the financial benefit is "one that is accrued as a member of a profession, occupation, or general class and is no greater than that which could reasonably be foreseen to accrue to all members of that profession, occupation, or general class." In other words, it's not a special gift to the ABC board member (or spouse, or relative, or associated business) just because the member is on the ABC board.
- If the financial benefit is "one that would be enjoyed to an extent no greater than that which other citizens of the State would or could enjoy." Again, the idea here is that the board member (or spouse, relative, or associated business) is not getting special treatment.
- If the financial benefit "is so remote, tenuous, insignificant, or speculative that a reasonable person would conclude under the circumstances that the local ABC board member's ability to

protect the public interest and perform the local ABC board member's duties would not be compromised."

- When an action affects or would affect the local board member's compensation as a local ABC board member.
- if, before participating in the action, the board member requested and received a written advisory opinion from the ABC Commission authorizing the board member's action.
- When the board's action is "ministerial only," that is, the action "does not require the exercise of discretion."
- When the board member is needed for purposes of obtaining a quorum, in which case the board member shall be counted for purposes of obtaining a quorum but shall not vote, and the minutes must reflect that a quorum could not be obtained without counting the affected board member.

**Disclosure required:** Local board members must "promptly disclose in writing" any conflicts of interest or potential conflicts of interest. Disclosure must be made to the local board.

Note that these exceptions will **not** excuse conduct that is prohibited under G.S. 14-234, G.S. 14-234.1, or G.S. 133-32 (all discussed below).

#### Confidential information (G.S. 18B-201(j))

Board members shall not "improperly use or improperly disclose any confidential information." This is similar to the prohibition in G.S. 14-234.1, which prohibits the use of non-public information gained in one's official position for pecuniary benefit or the pecuniary benefit of someone else. (However, violation of G.S. 14-234.1 is a Class 1 misdemeanor. The penalty for violating G.S. 18B-201(j) is removal from the board.)

#### Code of Ethics (G.S. 18B-706(a), (c))

Local boards are now required to adopt a code of ethics. The code must be consistent with the provisions in G.S. 18B-201 (discussed in part above), and must address:

1. The need to obey all applicable laws regarding official actions taken as a local board member or employee.
2. The need to uphold the integrity and independence of the local board member or employee's position.
3. The need to avoid impropriety in the exercise of official duties.
4. The need to faithfully perform the duties of the position.
5. The need to conduct the affairs of the board in an open and public manner, including complying with all applicable laws governing open meetings and public records.

The Commission is charged with developing a model code of ethics that local ABC boards may adopt (although it seems that the boards are free to develop their own code as well, as long as the code complies with the requirements set out above).

## Ethics Training (G.S. 18B-706(b))

Each local ABC board member is now required to receive a minimum of two hours of ethics education (1) within 12 months after initial appointment, and (2) again within 12 months of each subsequent appointment. The education “shall cover laws and principles that govern conflicts of interest and ethical standards of conduct for local ABC boards.” The education may be provided by the Commission or by another entity approved by the Commission. Each local board must maintain a record verifying receipt of the ethics education by each member of the board, and may require ethics training and education for board employees.

## **Summary of G.S. 14-234, G.S. 14-234.1, and G.S. 133-32**

### G.S. 14-234 – Conflicts of interest in contracting

#### A. Key terms

**Making a contract** - A public officer or employee is involved in **making a contract** if he or she participates in the preparation of the contract. A board member is also involved in making a contract if the board takes action on the contract, whether the board member participates in the board’s action or not. In other words, each board member is involved in making any contract entered into by the member’s unit of government.

**Administering a contract** - A public officer or employee is involved in **administering a contract** if he or she oversees the performance of the contract or has authority to make decisions regarding the contract or to interpret the contract.

**Direct benefit** - A public officer or employee receives a **direct benefit** if he or she—or his or her spouse:

- owns more than 10% of the company
- derives any income or commission directly from the contract, or
- acquires property under the contract.

#### B. What the statute prohibits

G.S. 14-234 prohibits three activities:

1. A public officer or public employee who **makes** or **administers** a contract on behalf of a public agency may not also derive a **direct benefit** from the contract (unless an exception applies).
2. A public officer or employee who will derive a **direct benefit** from a contract but is not involved in **making** or **administering** it shall not attempt to influence any other person who is involved in **making** or **administering** the contract.
3. A public officer or employee shall not solicit or receive any gift, favor, reward, service, or promise of reward, including a promise of future employment, in exchange for recommending, influencing, or attempting to influence the award of a contract by the public agency he or she serves.

### C. Consequences of violation

Violation of this statute can result in a Class 1 misdemeanor, punishable by up to 120 days imprisonment and a fine in an amount left to the judge's discretion (there is no maximum allowable fine for a Class 1 misdemeanor).

In addition, contracts entered into in violation of G.S. 14-234 are void.

### D. Exceptions

There are five exceptions to the conflicts of interest statute that permit contracts that would otherwise violate the statute as long as a public official with a conflict does not participate in any way or vote on the contract. These exceptions are:

1. contracts between a public agency and a bank, banking institution, savings and loan association, or a public utility;
2. interests in property conveyed by an officer or employee of a public agency under a judgment entered by a superior court judge in a condemnation proceeding initiated by the public agency (a "friendly" condemnation);
3. an employment relationship between a public agency and the spouse of a public officer of the agency;
4. payments by a public agency for certain public assistance programs; and
5. contracts entered into by small jurisdictions (cities having a population of no more than 15,000 and for counties that have no cities with a population of no more than 15,000 within them). **Note that this exception does not apply to local ABC boards.**

### G.S. 14-234.1 – Misuse of secret information

A board member may not use non-public information gained in the member's official position for the member's own pecuniary benefit or the pecuniary benefit of someone else

Violation of this statute can result in a Class 1 misdemeanor, punishable by up to 120 days imprisonment and a fine in an amount left to the judge's discretion (there is no maximum allowable fine for a Class 1 misdemeanor).

### G.S. 133-32 – Gifts and favors

#### A. What the statute prohibits

A public officer or employee may not accept gifts or favors from a past, current, or potential future vendor or contractor if the officer or employee is charged with the duty of any or all of the following:

- preparing plans, specifications, or estimates for public contracts;
- awarding or administering public contracts; or
- inspecting or supervising construction.

## B. Exceptions

Exceptions are allowed for:

- honoraria
- advertising items or souvenirs of nominal value
- meals at banquets
- gifts to professional organizations
- gifts from family or friends (which must be reported)

## C. Consequences of violation:

Violation of this statute can result in a Class 1 misdemeanor, punishable by up to 120 days imprisonment and a fine in an amount left to the judge's discretion (there is no maximum allowable fine for a Class 1 misdemeanor).

## Resources

A. Fleming Bell, II, *Ethics, Conflicts, and Offices: A Guide for Local Officials* (2<sup>nd</sup> edition forthcoming 2010)

Frayda S. Bluestein, *A Legal Guide to Purchasing and Contracting for North Carolina Local Governments* (2<sup>nd</sup> edition)

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