

June 8, 1995

**Advisory Opinion 1995 - No. 9**

**QUESTION**

The State Ethics Act prohibits legislators, in certain circumstances, from contracting with state agencies without prior approval of the Legislative Ethics Board and requires legislators who are awarded contracts with state agencies to file their contracts with the Board. Do these prior approval and filing provisions apply to contracts of the following nature:

*Contract (1):* A written contract between a physician who is a legislator and the Department of Labor and Industries under which contract the physician qualifies as an "independent medical examiner" in workers' compensation cases? This contract is executed on a form prescribed by the department. Many Washington State physicians have entered into this contract with the department. By entering into it, a physician is able to participate in the department's program providing for the evaluation of workers' compensation claims. Participating physicians are compensated for the evaluation services they render. The contract is not awarded in any kind of competitive bidding or selection process and generally any physician who has the appropriate credentials and has not been the subject of disciplinary proceedings may fill out the contract form and qualify as an "independent medical examiner." There is no competition among physicians for these contracts and the department actively encourages qualified physicians to enter into them.

*Contract (2):* An unwritten sales contract between a hardware store solely owned by a legislator and a state agency under which contract the agency, without any kind of competitive bidding or purchasing process, purchases nails for a price of twenty dollars? The nails are available in practically all hardware stores.

*Contract (3):* A written contract between a multinational corporation and a state agency where the corporation will provide data processing services to the state for a contract price of one million dollars, the legislator owns one hundred shares of the corporation's fifty million outstanding shares of stock, and the contract is not awarded through a competitive bidding or selection process in which bids or proposals are considered?

*Contract (4):* A written contract between a commercial greenhouse company and a state agency under circumstances where a legislator owns fifty-one percent of the company's outstanding shares of stock, the contract is for the sale to the state of shrubs for a price of eight hundred dollars, the shrubs to be sold are a common variety available at most greenhouses, and the contract is not awarded through a competitive bidding or selection process in which bids or proposals are considered?

*Contract (5):* A written contract between a state agency and real estate appraisal company under circumstances where a legislator owns one-third of the company's outstanding shares of stock, the company would appraise various properties at a total fee of ten thousand dollars, and the contract is not awarded through a competitive bidding or selection process in which bids or proposals are considered?

**OPINION**

The Board concludes that the State Ethics Act's contract approval requirements would apply

only to Contract (4) and that the Act's filing requirements would not apply to any of the contracts.

## ANALYSIS

In interpreting the State Ethics Act's provisions dealing with legislators' private business activities, the Board must be mindful of RCW 42.52.330, which provides:

By constitutional design, the legislature consists of citizen-legislators who bring to bear on the legislative process their individual experience and expertise. The provisions of this chapter shall be interpreted in light of this constitutional principle.

The Board believes that its answers to the questions in the opinion request are both consistent with this citizen-legislator provision and with the purpose of the Act's requirements relating to outside contracting by legislators.

### Is Board approval required?

The State Ethics Act, in subsection (2) of RCW 42.52.120, provides that:

. . . a state officer . . . may have a beneficial interest in a grant or contract with a state agency only if:

(a) The contract or grant is awarded or issued as a result of an open and competitive bidding process in which more than one bid or grant application was received;

(b) The contract or grant is awarded or issued as a result of an open and competitive bidding or selection process in which the officer's or employee's bid or proposal was the only bid or proposal received and the officer or employee has been advised by the appropriate ethics board, before execution of the contract or grant, that the contract or grant would not be in conflict with the proper discharge of the officer's or employee's official duties; or

(c) The process for awarding the contract or issuing the grant is not open and competitive, but the officer . . . has been advised by the appropriate ethics board that the contract or grant would not be in conflict with the proper discharge of . . . (his or her) official duties.

This provision generally requires a state officer, which includes a legislator<sup>1</sup>, to obtain the Board's prior approval of any contract with a state agency if the officer has a "beneficial interest" in the contract and if the contract is not awarded through an open and competitive bidding or selection process<sup>2</sup> in which more than one bid or proposal is received.

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<sup>1</sup> RCW 42.52.010(16) defines "state officer" and expressly provides that the term includes "members of the legislature."

<sup>2</sup> With exceptions, competitive bidding is required for state purchases. Important exceptions are for personal service contracts, emergency purchases, purchases that do not cost more than eight hundred dollars, and purchases for which there is a single source of supply. See: RCW 43.19.190 and RCW 43.19.1906.

With exceptions, state agencies awarding personal service contracts are required to use a formal "competitive solicitation" process under which contract proposals are solicited and considered by the agency. Important exceptions are provided for emergency contracts, sole source contracts, contracts under ten thousand dollars, contracts for client services, and

The first issue to be decided under this provision is whether a legislator would have a "beneficial interest" in the contracts outlined in the question. "Beneficial interest" is defined in RCW 42.52.010(4) as follows:

"Beneficial interest" has the meaning ascribed to it under the Washington case law. However, an ownership interest in a mutual fund or similar investment pooling fund in which the owner has no management powers does not constitute a beneficial interest in the entities in which the fund or pool invests.

Generally, under the case law and as applied to a public official's interest in a contract, the term is broadly defined to mean a financial interest.<sup>3</sup> That the Legislature intended the term to be broadly construed is shown by the definition's specific exclusion for remote interests in entities owned by mutual funds or similar investment pooling funds.

Applying this case law definition to the five contracts leads us to believe that in each of these contracts the legislator would have a "beneficial interest." Clearly, in each of them the legislator would have a financial interest. While this "interest" will be insignificant in some of the contracts (Contracts (2) and (3)), nonetheless the Board concludes it would qualify as a "beneficial interest."

The question now to be decided is whether the prior approval requirement in subsection (2) of RCW 42.52.120 applies to all contracts in which legislators have a "beneficial interest"? While a literal reading of the subsection would indicate that the answer is "yes," a more reasoned interpretation requires us to conclude that the answer is "no." Under the previously quoted RCW 42.52.330, we are required to interpret the State Ethics Act in a manner consistent with the citizen-legislator principle. We believe that legislators' burden of obtaining Board approval of contracts in which they have a beneficial interest exists only if such approval serves the purposes of the approval requirement. For us to require approval in other circumstances would conflict with our duty to interpret the law consistent with the citizen-legislator principle, as well as with common sense.

The purposes of the prior approval requirement are clearly shown by the legislative history of the State Ethics Act. The Act resulted from the recommendations of the Commission on Ethics in Government and Campaign Practices. In its report, the Commission states that its recommendations with respect to the contract approval and filing requirements address the following concerns:

The public interest can be compromised, or the appearance of integrity in the state's decision-making process can be compromised, if officials and employees can receive compensation for their personal services that impinge (or appear to impinge) upon their official duties. There is also concern that officials who seek personal services contracts . . . from state government receive favorable treatment from those who award the contracts.<sup>4</sup>

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contracts for architectural and engineering services. See: Chapter 39.29 RCW.

<sup>3</sup> See: *Northport v. Northport*, 27 Wash. 543 (1902); *Thiemens v. White*, 102 Wash. 453 (1918); *Mumma v. Brewster*, 174 Wash. 113(1933); *State v. Hurd*, 5 W.2d 662 (1940); *Kitsap County v. Bubar*, 14 W.2d 379 (1942); AGO 1965-66 - No. 53; and AGLO 1973 - No.6.

<sup>4</sup> Final Report of the State of Washington Commission on Ethics in Government and Campaign Practices, p. 19 (1994). Consistent with the Commission's recommendation, the filing requirement in the bill originally introduced to implement the Commission's recommendations was limited to "personal services" contracts. See: Section 112 of Senate Bill No. 6111, 1994 Sess. In subsequent versions of the bill, the "personal services" limitation was deleted, resulting in the filing requirement applying to contracts for goods as well as personal services.

Thus, as applied to legislators, we believe that the purposes of the prior approval provision are twofold: First, the provision is designed to promote the public interest and the appearance of integrity in legislative decision-making by preventing legislators from having contract interests that conflict, or appear to conflict, with their legislative duties. Second, the provision is designed to prevent legislators from benefitting from favoritism in the awarding of contracts by state agencies.

We will now apply the purposes of the prior approval provision to the five contracts before us.

*Contract (1):* It is difficult to see that the purposes of the prior approval requirement would be served by requiring the Board's approval of this contract. The purposes are not relevant where the circumstances are such that there is no competition among many possible contracting parties. Contract (1) is generally available to all qualified physicians who care to enter into it; physicians do not compete with one another for the contract. Thus, the possibility of favoritism in the awarding of the contract is absent. We conclude that the legislator need not obtain the Board's approval of this contract.

*Contract (2):* The legislator's interest in the sale of the bag of nails is certainly an extremely minimal interest. It is not reasonable to believe that the purposes of the approval provision would be served by requiring prior approval of this kind of trifling contract. Moreover, to burden a legislator with having to obtain approval of this contract would be unreasonable. We conclude that the legislator need not obtain the Board's approval of this contract.

*Contract (3):* The legislator's interest in the multinational corporation's contract also would be insignificant, given the relatively small number of shares of the corporation's stock owned by the legislator. While the contract amount is substantial, the legislator's interest in that amount is not. Moreover, the legislator's ability to exercise influence through his or her ownership interest in the multinational corporation would be practically nonexistent. The legislator would be an insignificant player in terms of participating in the business of the corporation. In fact, it would be reasonable to believe that the legislator may not even know about the corporation's contract. Clearly, the purposes of the prior approval requirement would not be served by requiring approval of this contract.

What are circumstances where a legislator's ownership of corporate shares will require prior approval of the corporation's state agency contract? Consistent with the purpose of the approval provision, we conclude that prior approval is required where the legislator-shareholder has a controlling financial interest in the corporation or a substantial management responsibility over the affairs of the corporation. Because the circumstances of this contract do not show that the legislator has such an interest or responsibility, approval of Contract (3) is not required.

*Contract (4):* Under this contract, the greenhouse company, in which the legislator owns fifty-one percent of the company's stock, would receive eight hundred dollars for the sale of shrubs that are available at most greenhouses. Because the legislator would have a controlling financial interest in this company, we conclude that the legislator must obtain the Board's approval of the contract.

*Contract (5):* Under this contract, a real estate appraisal company, in which a legislator owns one-third of the company's stock, would receive a ten thousand dollar appraisal contract from a state agency. The facts in the question do not show that the legislator has a controlling financial interest in the corporation or exercises substantial management responsibility over corporate affairs. Therefore, approval of the contract would not be required.

The Board notes that contracts such as this one may very well involve the legislator in

carrying out an important role in the negotiation or administration of the contract. If the circumstances presented in this question were such that the legislator was so involved, then the Board would find that the legislator exercises substantial management responsibility and would require that the contract be approved by the Board. Also, additional circumstances are possible where the legislator in this contract situation, notwithstanding his or her status as a minority shareholder, would have a controlling financial interest in the corporation. Some examples are when the legislator controls the voting rights of other shareholders; or when the combined shares of both the legislator and the legislator's spouse amount to a majority of the shares. In this last example, the Board would assume that majority ownership in the marital community would give the legislator a controlling financial interest in the corporation.

### **Must the contracts be filed with the Board?**

The State Ethics Act, in subsection (3) of RCW 42.52.120, provides that:

A state officer . . . awarded a contract [by a state agency] in compliance with subsection (2)<sup>5</sup> of this section shall file the contract . . . with the . . . ethics board within thirty days after the date of execution.

In *Advisory Opinion 1995 - No. 6*, we interpreted this provision and concluded that it would not require a legislator to file a contract between a state agency and a corporation where the facts revealed only that the legislator is an employee and a nominal stockholder of the corporation. Our basis for this conclusion was that the contracting parties would be the agency and the corporation, as opposed to the agency and the legislator.

While a literal interpretation of the filing provision would indicate that it requires filing of all contracts that are awarded by a state agency to a legislator and that comply with subsection (2), we conclude otherwise and do so for the same reasons we set forth in concluding that the approval provision should not be literally construed. As with the approval provision, we find that the more reasonable interpretation of the filing provision -- one that is consistent with legislative intent and the citizen-legislator principle -- is that filing is required only when it would serve the purposes of the filing requirement.

The Commission on Ethics in Government and Campaign Practices' purposes for this filing requirement are the same as the purposes for the approval requirement. As applied to legislators, the purposes are to promote the public interest and the appearance of integrity in legislative decision-making by preventing legislators from having contract interests that conflict, or appear to conflict, with their legislative duties; and to prevent legislators from benefitting from favoritism in the awarding of contracts by state agencies.

We will now apply the filing provision to the contracts before us.

*Contract (1)*: While this contract has been awarded to the legislator, we believe that the purposes of the filing requirements would not be served by applying the requirements to this contract. Therefore, we conclude that the legislator need not file this contract.

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<sup>5</sup> Subsection (2) is the previously discussed subsection requiring the Board's prior approval of state agency contracts that are not competitively bid or selected. We assume for purposes of this opinion that the contracts dealt with in this opinion have been awarded "in compliance with subsection (2). . . ."

*Contract (2):* Because the legislator is the sole owner of the hardware store, the contract arguably would be "awarded" to the legislator. We say "arguably" here because one does not normally think of such an insignificant contract as being "awarded." However, assuming that it is "awarded," we believe here also that the purposes of the filing requirement would not be served by requiring that this contract be filed. We conclude that the legislator need not file this contract.

*Contract (3):* This contract has been awarded to the multinational corporation, not to the legislator. Therefore, the legislator need not file it.

*Contract (4):* This contract has been awarded to the greenhouse company, not to the legislator. Therefore, the legislator need not file it. (This contract would not escape Board scrutiny because, as previously discussed, the legislator would be required to obtain the Board's prior approval of the contract.)

*Contract (5):* This contract has been awarded to the real estate appraisal corporation, not to the legislator. Therefore, the legislator need not file it. (This contract would not escape Board scrutiny if the member would exercise any substantial management responsibilities over it. The exercise of such responsibilities would result in the legislator having to obtain the Board's prior approval of the contract.)

## **Summary**

Where a state agency contract is not awarded in an open and competitive bidding or selection process involving a number of bids or proposals, the State Ethics Act requires a legislator with a private financial interest in the contract to obtain this Board's prior approval of the contract.

We hold that the Act's prior approval provisions are inapplicable in instances where approval would not serve the purposes of the provisions. These purposes would not be served by requiring a legislator to obtain approval of any of the following state agency contracts in which the legislator has a private financial interest: (1) a contract of such wide availability that there is no competition among many possible contracting parties for it and, therefore, no opportunity for favoritism in the awarding of the contract; or (2) a contract in which the legislator has an extremely minimal interest; or (3) a contract where the contracting entity is a corporation and the legislator possesses neither a controlling financial interest in the corporation nor substantial management responsibilities over corporate business, particularly with respect to the contract. As such, approval of Contracts (1), (2), (3), and (5) would not be required, but approval of Contract (4) would be required.

The State Ethics Act also requires a legislator to file with this Board any state agency contract "awarded" to the legislator. The legislator would not be required to file any of the five contracts addressed in this opinion. As with the approval provisions, we conclude that the Act's filing provisions are inapplicable in instances where filing would not serve the purposes of the filing provisions. These purposes would not be served by requiring the filing of: (1) a contract of such wide availability that there is no competition among many possible contracting parties and, therefore, no opportunity for favoritism in the awarding of the contract; or (2) a contract in which the legislator has an extremely minimal interest. As such, filing of Contracts (1) and (2) would not be required. The remaining contracts, Contracts (3), (4), and (5), would not have to be filed because none of them would be "awarded" to the legislator.