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## Coates' Canons Blog: Conflicts of Interest and Subcontractors

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One of your city council members, Georgia Peach, is a plumber, and owns her own plumbing business, Peaches & Plumbs, LLP. Peaches & Plumbs often subcontracts with one of the bigger and more reputable general contractors in town, Constructive Construction, Inc. Your city is getting ready to renovate the town hall, and, as it turns out, the lowest responsive bid is from Constructive Construction. If you determine that Constructive Contractors is a responsible bidder, can you award the contract to them, knowing that they're likely to subcontract with Peaches & Plumbs? Doesn't that create a conflict for Georgia Peach?

### Legal considerations: G.S. 14-234

First, let's take a look at what I think of as the "self dealing" statute: **G.S. 14-234**. G.S. 14-234(a)(1) prohibits public officials or employees who are involved in making or administering contracts on behalf of their local government from receiving a direct benefit from those contracts. (G.S. 14-234 has also been the subject of several previous Coates' Canons blog posts, which are listed at the end of this post for ease of reference.) The statute defines the terms "making a contract," "administering a contract," and "direct benefit." Under G.S. 14-234(a1)(3), "making a contract" means that the public official or employee "participates in the development of specifications or terms or in the preparation or award of the contract." And importantly, the statute states that "[a] public officer is also involved in making a contract if the board, commission, or other body of which he or she is a member takes action on the contract, **whether or not the public officer actually participates in that action**, unless the contract is approved under an exception to this section under which the public officer is allowed to benefit and is prohibited from voting." (Emphasis mine.) "Administering a contract" means that the public official or employee "oversees the performance of the contract or has authority to make decisions regarding the contract or to interpret the contract." G.S. 14-234(a1)(2). Clearly, then, Georgia Peach is involved in "making" and "administering" the contract with Constructive Construction, Inc.—even if she doesn't vote on it!

But does she derive a "direct benefit"? Under G.S. 14-234(a1)(4), Georgia will derive a "direct benefit" from the contract with Constructive Construction if she or her husband "(i) has more than a ten percent (10%) ownership or other interest in an entity that is a party to the contract; (ii) derives any income or commission directly from the contract; or (iii) acquires property under the contract."

Remember that we're talking about two separate contracts here: Contract # 1 would be between Constructive Construction and the city, and Contract # 2 would be between Constructive Construction and Peaches & Plumbs. Since Georgia and her husband have no ownership interest in Constructive Construction, she doesn't derive a direct benefit under the first prong of the definition. As for the second prong, Georgia and her husband will also not derive income or commission "directly" from "the" contract—that is, the contract between Constructive Construction and the city. Sure, she'll derive income under Contract # 2—but she'd derive that income **indirectly**—not directly—from Contract # 1. Finally, will she acquire property under the contract? Probably not—again, she will receive income indirectly from Contract # 1 through Contract # 2, but this part of the definition of "direct benefit" is used to address situations where a public officer or employee receives property **other** than money or income from a contract with the public entity he or she serves. (For example, as I discussed in **an earlier post**, if Georgia Peach bought an old computer from the city, that would be a direct benefit prohibited by G.S. 14-234.) And, again, she's not acquiring property under "the" contract—Contract # 1—but from Contract # 2.

The bottom line is that we don't know if a court would find that the definition of "direct benefit" includes income received by subcontractors. In 2004, the North Carolina Court of Appeals held that there was a violation of G.S. 14-234 where a

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county awarded a construction contract to a contractor which then subcontracted the work to the chair of the county board of commissioners. See **Gibbs v. Mayo, 162 N.C.App. 549, 591 S.E.2d 905 (2004)**. However, the case was decided based on an earlier and substantially different version of G.S. 14-234. (This earlier version of G.S. 14-234 did not use the terms “making a contract,” “administering a contract,” or “direct benefit.” Instead it stated that “If any person appointed or elected a commissioner or director to discharge any trust wherein the State or any county, city or town may be in any manner interested shall become an undertaker, or make any contract for his own benefit, under such authority, or be in any manner concerned or interested in making such contract, or in the profits thereof, either privately or openly, singly or jointly with another, he shall be guilty of a misdemeanor.”) The facts in that case were pretty unusual, too—the chairman actually performed almost all of the work on the projects in those cases, and the general contractor was listed as the contracting party apparently as a way of “laundering” the contract so it would pass muster under G.S. 14-234. And the North Carolina courts haven’t addressed the issue since then.

So, although the city probably can award the contract to Constructive Construction, a court could still find that the subcontracting arrangement with Georgia Peach violates G.S. 14-234(a)(1). (Note that if this was the type of contract where Constructive Construction was required to list its subcontractors on its bid, and Constructive Construction listed Peaches & Plumbs as its plumbing subcontractor, a court may be more likely to find that Peaches & Plumbs would receive a direct benefit from the city’s award of Contract # 1 to Constructive Construction.) What’s the risk to Georgia if this arrangement violates G.S. 14-234(a)(1)? Well, anyone violating G.S. 14-234 is guilty of a Class 1 misdemeanor (punishable by up to 120 days imprisonment and a fine in an amount left to the judge’s discretion), and contracts awarded in violation of G.S. 14-234 are void. G.S. 14-234(e), (f).

### **Other legal considerations**

Even if G.S. 14-234(a)(1) should turn out not to be a problem here, there are a few other issues that Georgia will need to watch out for. G.S. 14-234(a)(3) prohibits any public officer or employee from asking for or receiving “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.” (This part of the statute was amended by **Session Law 2010-169**, signed by the Governor on August 2, 2010.) If Georgia recommends, influences, or attempts to influence the award of the contract to Constructive Construction, does the fact that Constructive Construction has listed her company as a subcontractor on the contract count as a “gift, favor, reward, service, or promise of reward”? Probably not, but under the right set of circumstances, it could look that way. And, again, a violation of G.S. 14-234 is a Class 1 misdemeanor.

**G.S. 14-234.1** could also present an issue for Georgia. It prohibits public officials or employees from gaining a “pecuniary interest” or “pecuniary benefit”—or to intentionally aid someone else to gain such an interest or benefit—from non-public information gained through the person’s official position. For example, if Georgia acquired some non-public information about this building project through her position on the board, and shared that non-public information with Constructive Construction to make their bid more appealing to the board, that would violate G.S. 14-234.1. Punishment? Another Class 1 misdemeanor.

Finally, even if the contract doesn’t violate G.S. 14-234, Georgia may not be able to vote on the contract under the voting statute, **G.S. 160A-75 (G.S. 153A-44** for counties). I won’t discuss this further here, because my colleague Frayda Bluestein wrote an **excellent blog post** about this last year.

### **Ethical considerations**

Aside from the murkiness of the legal issues here, there’s plenty of ethical murkiness to make this situation unappealing. The ethical principles of fairness and impartiality are cornerstones of the public bidding process, and if the city awards the contract to Constructive Construction, and Peaches & Plumbs gets the plumbing subcontract, the other bidders and other plumbing subcontractors may feel that they were treated unfairly because of Peach’s position on the board. And can Georgia truly say that her position on the board had nothing to do with Constructive’s decision to award the subcontract to her?

### **Practical considerations**

If Peaches & Plumbs is awarded the subcontract, this will create practical issues as well. Imagine what would happen if

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the city awarded the contract to Constructive Construction, and then Constructive Construction and Peaches & Plumbs start having problems with each other. (You know how this goes: Peaches & Plumbs says they aren't getting paid, and Constructive Construction says they won't pay for the slipshod work that they've been seeing from Peaches & Plumbs, and so on.) Where does this put Georgia Peach? In a pickle! Her duties to the board and to her constituents are coming into conflict with her role as the owner of Peaches & Plumbs. This will be uncomfortable for her and for the other board members as well.

## Conclusion

In sum, it's probably smarter for board members and other public officials and employees who are involved in making and awarding contracts on behalf of the entity they serve to avoid subcontracting on contracts with that entity. However, until we know for sure whether a North Carolina court would determine that such subcontracts violate G.S. 14-234, that decision is one that the public official or employee will need to make for himself or herself (in consultation with their attorney). The governing board does not have the authority to reject a bid from the lowest responsive, responsible contractor based solely on the possibility that a public official or employee may be hired as a subcontractor.

For additional reading on this topic, take a look at Fleming Bell's **Construction Contracts with North Carolina Local Governments** at pages 40-43.

## Other blog posts discussing G.S. 14-234

Boards of Health and Conflicts of Interest (Jill Moore 7/1/10)

Board Members as Employees (Frayda Bluestein 1/6/10)

Federal Grants and Codes of Conduct (Eileen Youens 11/4/09)

I Second that Amotion (Frayda Bluestein 10/28/09)

When can a local government employee or official buy surplus property from the local government? Part 2 (Eileen Youens 9/22/09)

Conflicts of Interest: How Do The Voting Statutes Relate to the Criminal Statute? (Frayda Bluestein 9/9/09)

## Links

- [www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_14/GS\\_14-234.html](http://www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_14/GS_14-234.html)
- [appellate.nccourts.org/opinions/?c=2&pdf=22332](http://appellate.nccourts.org/opinions/?c=2&pdf=22332)
- [www.ncga.state.nc.us/Sessions/2009/Bills/House/HTML/H961v8.html](http://www.ncga.state.nc.us/Sessions/2009/Bills/House/HTML/H961v8.html)
- [www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_14/GS\\_14-234.1.html](http://www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_14/GS_14-234.1.html)
- [www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_160A/GS\\_160A-75.html](http://www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-75.html)
- [www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_153A/GS\\_153A-44.html](http://www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_153A/GS_153A-44.html)
- [www.sog.unc.edu/publications/books/construction-contracts-nc-local-governments](http://www.sog.unc.edu/publications/books/construction-contracts-nc-local-governments)