

# **Managing Conflicts of Interest in the Public Sector**

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Managing conflicts of interest in the public sector requires careful consideration of both legal and ethical expectations.

Public officials need to take great care to avoid situations where they could be accused of using their position to further their personal interests.

Impartiality and transparency in administration are essential to maintaining the integrity of the public sector. Where activities are funded by public funds, or are undertaken in the public interest, taxpayers will have strong expectations of probity. Media and the public take a strong interest when they think public resources are being used irresponsibly or misused for private benefit.

## **The nature of conflicts of interest**

A conflict of interest arises where two different interests intersect. In the public sector, a conflict of interest exists where a person's duties or responsibilities to a public entity could be affected by some other separate (and usually private) interest or duty that he or she may have.

That other interest or duty might exist because of:

- the person's financial affairs;
- a relationship or role that he or she has; or
- something he or she has said or done.

Public perceptions are important. It is not enough that public officials are honest and fair; they should also be clearly seen to be so.

Labelling a situation as a "conflict of interest" does not mean that corruption or some other abuse of public office has actually occurred. Usually, there is no suggestion that the person concerned has in fact taken advantage of the situation for their personal benefit or been influenced by improper personal motives. But a perception of the possibility for improper conduct – no matter how unfair to the individual – can be just as significant. The key issue is whether there is a reasonable risk, to an outside observer, that the situation could undermine public trust and confidence in the official or the public entity.

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<sup>1</sup> Presentation to the LexisNexis Public Sector In-house Counsel Forum, 17 November 2005.

In other words, the existence of a conflict of interest does not necessarily mean that the person concerned has done anything wrong. What it does is create an issue that needs to be managed carefully by the public entity.

## **The legal and ethical dimensions**

Conflicts of interest can have both legal and ethical dimensions.

### *Legal obligations*

Legal obligations can arise from both statute and the common law.

### Statutory requirements

In recent years, it has become increasingly common for public entities to have statutory rules about particular types of conflicts of interest inserted into their own governing legislation.<sup>2</sup> These provide the clearest rules about what must or must not be done in a given situation. Non-compliance may lead to civil or criminal consequences for the individual concerned, or may affect the validity of the entity's decision.

Some – but more limited – rules<sup>3</sup> apply to private sector organisations.

Most of the statutory requirements apply only to members of the governing body of an entity. It is unusual for them to apply to employees or contractors. The contents of the statutory requirements vary across different types of entities, but they commonly do one or more of the following:

- Prohibit members from discussing and voting at meetings on matters in which they have an interest;
- Require members to disclose interests at relevant meetings, and/or in a register of interests, and/or before appointment;
- Prohibit members from being interested in certain contracts with their entity;

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<sup>2</sup> See, for example, the Crown Entities Act 2004, sections 31, 62-72 and 90; Education Act 1989, sections 103A-103B, 175, and clause 8(8) of Schedule 6; New Zealand Public Health and Disability Act 2000, clause 6 of Schedule 2, clause 36 of Schedule 3, and clauses 6, 38 and 39 of Schedule 4; Local Authorities (Members' Interests) Act 1968, sections 3 and 6; Health Practitioners Competence Assurance Act 2003, clauses 11-14 of Schedule 3; Gambling Act 2003, section 231; Weathertight Homes Resolution Services Act 2002, section 35; Health and Disability Services (Safety) Act 2001, section 33; Local Government Act 2002, clauses 17-23 of Schedule 4; Maori Television Service Act 2003, clauses 6-10 of Schedule 2; Chartered Professional Engineers of New Zealand Act 2002, clauses 13-16 of Schedule 1; Corrections Act 2004, section 167; Courts Security Act 1999, section 7; Fisheries Act 1996, section 296O; Crown Minerals Act 1991, section 94. Before the enactment of the Crown Entities Act in late 2004, many of the statutory entities now covered by that Act already had similar provisions in their individual governing statutes. Similar rules also apply to members of Parliament and Ministers: see the Standing Orders of the House of Representatives, SO 163A-166 and Appendix B; and the Cabinet Manual, paragraphs 2.52-2.55.

<sup>3</sup> Companies Act 1993, sections 139-149; Securities Markets Act 1988, sections 19T-19ZA and 20-29; Building Societies Act 1965, section 86.

- Prohibit members from signing documents relating to matters in which they are interested;
- Provide that breaching the requirements constitutes grounds for removal from office, and/or constitutes an offence, and/or enables certain of the entity's acts to be avoided;
- Provide mechanisms for seeking exemptions from the requirements.

Other, more general, statutory duties can also be said to impose obligations on public entities to carefully manage conflicts of interest. Certain types of entities (or their members or employees) are required to, for instance, act in a manner consistent with the spirit of service to the public;<sup>4</sup> maintain proper standards of integrity, conduct, and concern for the public interest;<sup>5</sup> act with honesty and integrity;<sup>6</sup> refrain from pursuing personal interests at the expense of the entity's interests;<sup>7</sup> and comply with the minimum standards of integrity and conduct that may be specified in a code of conduct.<sup>8</sup>

### Bias at common law

Whether or not any statutory rule applies, a person who exercises powers that can affect the rights and interests of others may also be subject to the common law rule about bias. Persons in such a position must carry out their duties fairly and free from prejudice. If a decision is tainted by bias, the courts may declare it invalid on a judicial review application.<sup>9</sup>

The current judicial expressions of the test for bias are:

Is there, to a reasonable, fair-minded and informed observer, a real danger of bias on the part of a member of the decision-making body, in the sense that he or she might unfairly regard with favour (or disfavour) the case of a party to the issue under consideration?<sup>10</sup>

and

Would the reasonable, informed observer think that the impartiality of the decision-maker might have been affected?<sup>11</sup>

Because I am addressing an audience largely comprised of lawyers, I will not spend time discussing in detail the meaning – and importance – of the legal concept of bias,

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<sup>4</sup> Crown Entities Act 2004, section 50.

<sup>5</sup> State Sector Act 1988, sections 56(3) and 77A(3); and Education Act 1989, section 181.

<sup>6</sup> Crown Entities Act 2004, section 54.

<sup>7</sup> Crown Entities Act 2004, section 55.

<sup>8</sup> State Sector Act 1988, section 57A; and Local Government Act 2002, clause 15 of Schedule 7.

<sup>9</sup> Our August 2004 publication *Conflicts of interest - A guide to the Local Authorities (Members' Interests) Act 1968 and non-pecuniary conflicts of interest* contains guidance for members of local authorities about how to apply the law relating to bias. See in particular Parts 1 and 5, and the caselaw discussed in Appendices B and C.

<sup>10</sup> *R v Gough* [1993] AC 646 (HL); as modified in *Porter v Magill* [2002] 2 WLR 37 (HL).

<sup>11</sup> *Ngati Tahinga and Ngati Karewa Trust v Attorney-General* (2003) 16 PRNZ 878 (CA); and *Erris Promotions v Commissioner of Inland Revenue* (2003) 21 NZTC 18,214 (CA).

except to note that it is the appearance of bias, not proof of actual bias, that is important.<sup>12</sup>

### *Ethical expectations*

Managing conflicts of interest in the public sector often involves more than just consideration of the law. The term “conflicts of interest” can be used to describe a range of other behaviour that may be regarded as unethical, albeit not unlawful.

Only some types of conflict of interest involve legal obligations. The legal requirements may not be relevant to:

- personnel who are not on the entity’s governing body;
- people who make decisions outside formal meetings or hearings;
- subordinate officials who advise or work for the actual decision-maker; and
- people who are not exercising statutory powers.

Therefore, for many situations involving employees, advisers or contractors, there may well be no doubts over legality, but the situation may nevertheless be questionable.

The ethical dimension of conflicts of interest involves issues of integrity, honesty, openness, and good faith. A high standard of behaviour is expected of those involved in public life. A public entity must avoid situations where its officials could be accused of using their positions to further their private interests. Regardless of whether or not any legal requirement applies, a conflict of interest will always involve ethical considerations.<sup>13</sup>

Our November 2004 report, *Christchurch Polytechnic Institute of Technology’s management of conflicts of interest regarding the Computing Offered On-Line (COOL) programme*,<sup>14</sup> examines the nature of public sector conflicts of interest in that broader ethical context. In that case, no legal rules had been breached, but we discussed in detail what the Auditor-General considers to be generally accepted ethical expectations when conflicts of interest arise in relation to a person working for a public entity.

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<sup>12</sup> Interested readers who want to study recent cases that examine the nature and application of the legal test for bias can refer to *Collinge v Kyd* [2005] 1 NZLR 847; *Zaoui v Greig* (HC, Auckland, CIV-2004-404-000317, 31 Mar 2004, Salmon & Harrison JJ); *Pratt Contractors v Transit New Zealand* [2005] 2 NZLR 433 (PC); *Ngati Tahinga and Ngati Karewa Trust v Attorney-General* (2003) 16 PRNZ 878 (CA); *Erris Promotions v Commissioner of Inland Revenue* (2003) 21 NZTC 18,214 (CA); *Man O’War Station Ltd v Auckland City Council (No 1)* [2002] 3 NZLR 577 (PC); *Porter v Magill* [2002] 2 WLR 37 (HL); *Riverside Casino v Moxon* [2001] 2 NZLR 78 (CA); *Locabail (UK) v Bayfield Properties* [2000] 1 All ER 65; *R v Bow Street Metropolitan Stipendiary Magistrate ex parte Pinochet Ugarte (No 2)* [1999] 1 All ER 577 (HL); *East Pier Developments v Napier City Council* (HC, Napier, CP26/98, 14 Dec 1998, Wild J); *R v Secretary of State for the Environment, ex parte Kirkstall Valley Campaign* [1996] 3 All ER 304; *Auckland Casino Ltd v Casino Control Authority* [1995] 1 NZLR 142 (CA); *R v Gough* [1993] AC 646 (HL); *Calvert v Dunedin City Council* [1993] 2 NZLR 460.

<sup>13</sup> The ethical dimension of conflicts of interest can also be linked to the broad statutory obligations, applying to some public entities, that are described at footnotes 4-8.

<sup>14</sup> This report is also available from our Office, or our website: [www.oag.govt.nz](http://www.oag.govt.nz). See in particular the Foreword, Part 2, and Appendix 1.

## Identifying conflicts of interest

A conflict of interest arises when a particular matter concerning a person in their public role intersects with that person's other interest.

It is the *intersection* of those two interests that must be considered. The mere existence of the other interest, on its own, may not necessarily cause a conflict. Therefore, one must always focus on what the private interest has to do with the particular matter (that is, the question, decision, project or activity) that is being considered by the public entity.

One way of considering whether a conflict of interest may exist is to ask:

Does the issue create an incentive for the person to act in a way that may not be in the best interests of the public entity?

The issue is not confined to a consideration of the possibility of financial loss to the public entity concerned. It can relate to the potential for public funds, resources, time or position being used by someone to advance their own private interests.

### *Causes of conflicts of interest*

A conflict of interest can arise in any number of ways. It can arise from a financial interest, or a non-financial association. It can be professional or personal. It can be caused by, among other things:

- employment with another organisation;
- involvement in another business;
- professional or legal obligations owed to someone else;
- holding another office;
- membership of another organisation;
- investments and property ownership;
- beneficial interests in trusts;
- gifts and hospitality;
- debts;
- family or close personal relationships; and
- strong political or personal beliefs or public statements that may indicate predetermination.

As already noted, it is not the fact of the private interest alone that constitutes a conflict of interest. A conflict arises only if, in a particular situation, there is a connection between that interest and the person's responsibilities to the public entity.

### *Distinguishing financial and non-financial conflicts of interest*

Financial (often called pecuniary) conflicts of interest are often treated more strictly than non-financial conflicts of interest. At common law, any financial conflict of interest amounts to an automatic disqualification from participation in the decision,

regardless of any suggestion of actual or apparent bias.<sup>15</sup> In other words, where the conflict of interest is financial, bias is presumed to exist. Many of the statutory requirements also focus primarily on financial interests.

A financial conflict of interest is one where the decision or act could reasonably give rise to an expectation of financial gain or loss to the conflicted person. A financial interest need not involve cash changing hands directly. It could, for instance, relate to effects on the value of land or shares that the person owns, or effects on the turnover of a business that the person is involved in.<sup>16</sup>

## Managing conflicts of interest

There are no prescriptive and comprehensive written definitions or “rules” for identifying and dealing with conflicts of interest that apply to all situations across the entire public sector. Nor should there be. The concept of conflicts of interest can cover an infinite range of situations, of varying seriousness. Moreover, each entity’s own circumstances are likely to generate different needs and concerns.

There are two ways in which a public entity can manage conflicts of interest. They are by:

- having effective policies and procedures; and
- identifying, disclosing, and then making prudent decisions about difficult or novel conflict-of-interest situations on a case-by-case basis.

### *Policies and procedures*

Managing conflicts of interest can never be as simple as just creating and enforcing a blunt set of rules. Nevertheless, robust policies and procedures within an entity are an important starting point. They can provide clear rules for the most obvious situations, and establish a process for dealing with the more difficult ones.

Policies and procedures could usefully provide for most or all of the following matters:

- state principles that emphasise the entity’s commitment to addressing conflicts of interest, and the importance of people within the entity being alert for such situations;
- establish rules for the most important and obvious actions that people must or must not take;
- establish a mechanism (such as an interests register) for recording those types of ongoing interests that can commonly give rise to a conflict of interest, and a procedure for putting this into effect and updating it on a regular basis;

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<sup>15</sup> Subject to a de minimis threshold: *Auckland Casino Ltd v Casino Control Authority* [1995] 1 NZLR 142 (CA).

<sup>16</sup> For some examples of situations held to involve financial conflicts of interest in the local authority context, see the cases discussed in Appendix B of our publication *Conflicts of interest - A guide to the Local Authorities (Members’ Interests) Act 1968 and non-pecuniary conflicts of interest*.

- set out a process for identifying and disclosing instances of conflicts of interest as and when they arise (including a clear explanation of how a person should disclose a conflict of interest, and to whom);
- set out a process for managing conflicts of interest that arise (including who makes decisions, and perhaps detailing the principles, criteria, or options that will be considered);
- provide avenues for training and advice;
- provide a mechanism for handling complaints or breaches of the policy; and
- specify the potential consequences of non-compliance.

In developing its own policies and procedures, a public entity should take into account the nature of its own particular structure, functions and activities, and any applicable legislative requirements.

### *Making decisions about particular situations*

However, policies and procedures are no substitute for effective management of individual dilemmas as they arise. No matter how comprehensive a set of policies and procedures is, not every factual scenario can be predicted and provided for. In addition, some types of conflict might not be able to be dealt with by a firm rule one way or the other, since the seriousness of many intersecting interests will be a question of degree. Accordingly, the decision about how to treat some situations may need to be the subject of discretionary judgements by the entity on a case-by-case basis.

There are two aspects to dealing with particular situations:

- identifying and disclosing the conflict of interest (primarily the responsibility of the individual concerned); and
- deciding how best to avoid or mitigate the effects of the conflict of interest (primarily the responsibility of the entity).

The person with the conflict of interest has the obligation to identify – and disclose – it to the necessary people (usually his or her superiors) in a timely and effective manner. From a transparency perspective, disclosure is better than the individual silently trying to manage the situation themselves.

Once the conflict of interest has been identified and disclosed, the entity needs to carefully consider what, if anything, needs to be done to adequately avoid or mitigate the effects of the conflict of interest. The primary obligation to determine the appropriate next steps (and to direct the person accordingly) usually lies with the public entity.<sup>17</sup> The entity's chair, chief executive, legal advisers, human resources staff, and other managers need to take an active role here.

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<sup>17</sup> Unless those steps are already clearly determined by a legal requirement or written policy that the person ought to be aware of. Where a legal requirement about participating in meetings is involved, for instance, the obligation (and sanction for failure to comply) will often lie wholly or largely with the individual concerned.

The question of what steps to take in any given situation will require careful assessment. Relevant factors include:

- the type or size of the person's other interest;
- the nature or significance of the particular decision or activity being undertaken by the public entity;
- the degree to which the person's other interest could affect, or be affected by, the public entity's decision or activity;
- the nature or extent of the person's current or intended involvement in the public entity's decision or activity; and
- the practicability of any options for avoiding or mitigating the conflict.

In cases where the conflict of interest can safely be regarded as remote or insignificant, it will be reasonable to formally record or declare the conflict in some form, but for the entity to decide to take no further action. However, it is important for the entity to give active consideration to whether something more ought to be done. It is not generally safe to simply assume that a disclosure, with nothing more, is always adequate.<sup>18</sup>

In the more serious cases, some further steps will be necessary.<sup>19</sup> There is a broad range of options – from slight to serious – for avoiding or mitigating a conflict of interest. The options include:

- enquiring as to whether all affected parties will consent to the person's involvement;
- imposing additional oversight or review over the person;
- withdrawal from discussing or voting on a particular item of business at a meeting;
- exclusion from a committee or working group dealing with the issue;
- re-assigning certain tasks or duties to another person;
- agreement or direction not to do particular acts;
- placing restrictions on access to certain confidential information;
- transferring the person (temporarily or permanently) to another position or task;
- relinquishing the private interest; or
- resignation or dismissal from one or other position or entity.

The key message here is that, in the public sector, simply declaring a conflict of interest may not be enough. Once a conflict of interest has been identified or declared, the entity may need to take further steps to remove any possibility – or perception – of taxpayers' funds being used for private gain. The most typical steps involve withdrawal or exclusion from involvement in the public entity's work on the matter.

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<sup>18</sup> The only time when this is a fair assumption to make is when an applicable legislative provision expressly permits full participation following a disclosure. Some legislation aimed at the private sector permits this (the Companies Act is the best-known example), but most legislation specific to the public sector does not (although it may provide a process for formal exemptions to be sought and granted).

<sup>19</sup> Very occasionally a conflict of interest may be inevitable and unavoidable, and the matter may have to proceed with the person's involvement.

## The role of central agencies

### *The Auditor-General*

As the auditor of all public entities,<sup>20</sup> the Auditor-General has an interest in encouraging them to carry out their activities lawfully and responsibly.

Under his performance audit and inquiry functions, the Auditor-General may examine matters concerning a public entity's use of its resources, or its compliance with its statutory obligations, or matters appearing to show a lack of probity by a public entity or its members, office holders or employees.<sup>21</sup> These functions sometimes involve inquiring into and reporting publicly on the management of conflicts of interest by a public entity or someone within a public entity.<sup>22</sup>

### *The State Services Commission*

The State Services Commissioner has a leadership role in articulating and reinforcing public sector values and standards.

Under section 57 of the State Sector Act 1988, the Commissioner sets minimum standards of integrity and conduct for the Public Service and, from time to time, issues these in the *Public Service Code of Conduct*.<sup>23</sup> The Code applies only to departments of the Public Service.<sup>24</sup> However, other public entities may find the code of significant persuasive value as an expression of the general standards expected of the wider public sector. In January 2005, section 57 was extended to cover most Crown entities and certain other non-Public Service departments. The Commissioner is currently developing a code or codes for those agencies.

The State Services Commission also publishes a range of other useful guidance in this area,<sup>25</sup> and can conduct investigations into allegations of improper behaviour by state servants.<sup>26</sup>

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<sup>20</sup> The Auditor-General is the auditor of every public entity: Public Audit Act 2001, section 14. The term "public entity" is defined in section 5 of that Act.

<sup>21</sup> The Auditor-General's general audit and inquiry functions and powers are set out in Parts 3 and 4 of the Public Audit Act. See especially sections 16 and 18.

<sup>22</sup> Recent inquiries that have involved conflicts of interest include *Christchurch Polytechnic Institute of Technology's management of conflicts of interest regarding the Computing Offered On-Line (COOL) programme* (2004); *Inquiry into Expenses Incurred by Dr Ross Armstrong as Chairperson of Three Public Entities* (2003); *Inquiry into Public Funding of Organisations Associated with Donna Awatere Huata MP* (2003); *Report on the Disposal of 17 Kelly Street by The Institute of Environmental Science and Research Limited* (2003). See also the general guidance in the *Christchurch Polytechnic report* and in *Conflicts of interest - A guide to the Local Authorities (Members' Interests) Act 1968 and non-pecuniary conflicts of interest*, and the range of publications by other agencies listed in Appendix 1 to the *Christchurch Polytechnic report*.

<sup>23</sup> The latest edition was published in February 2005.

<sup>24</sup> The "Public Service" is defined in section 27 and Appendix 1 of the State Sector Act.

<sup>25</sup> See for instance *Integrity and Conduct: Setting Standards for Crown Entities* (2005); *Best Practice Guidelines for Departments Responsible for Regulatory Processes with Significant Commercial Implications* (2004); *Walking the line: Managing conflicts of interest - Resource kit* (2003); *Board appointment and induction guidelines* (1999).

## **The role of lawyers advising public entities**

In the public sector, it is important not to confine advice to simply whether any statutory rule applies or whether the agency may be exposed to judicial review. Public entities and their advisers also need to carefully consider how to manage the ethical dimension of conflicts of interest.

Public or media outrage over a possible impropriety is not dependent solely on whether the act in question was unlawful. In-house counsel and other advisers of public entities can add value by proactively encouraging their clients to recognise and take into account the ethical dimension (and the political risks) of conflicts of interest in the public sector. By doing so, they can help ensure that issues are identified and managed carefully before they cause real trouble.

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<sup>26</sup> Sections 6, 8, 11, 57B and 57C of the State Sector Act. See for example *Report for State Services Commissioner on Civil Aviation Authority Policies Procedures and Practices relating to Conflicts of Interest and Conduct of Special Purpose Inspections and Investigations* (2003).