OFFICE OF THE GOVERNOR

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December 4, 2001

RQ-0473-JC

The Honorable John Cornyn
Texas Attorney General
P.O. Box 12548
Austin, TX 78711-2548

FILE # ML-42309-01
I.D. # 42309

ATTN: Opinions Division

Re: Request for clarification of Opinion No. JC-0426

Dear General Cornyn:

I. Introduction

Recently your office determined that the common law barred Texas Woman's University (TWU) from maintaining a 50-year depository relationship with a bank that employs one of its regents. Opinion No. JC-0426 (Oct. 22, 2001). You reached this conclusion despite the fact that the regent had no role in TWU's selection of the bank, which had occurred before his appointment. Moreover, TWU had selected the bank through a sealed bid process that would have precluded any favoritism to the bank even if the regent had been employed there at the time of selection. Further, to avoid the appearance of a conflict of interest, the regent had promised to refrain from voting on any future matters relating to the depository relationship after fully disclosing his employment with the bank.

You also acknowledged that the regent had no ownership or control interest in the bank – he is not a shareholder or director, but merely an officer (vice president) and employee. You nonetheless determined that this employment relationship was sufficient to give rise to a pecuniary "interest" that would bar the depository relationship under the "common law conflict of interest doctrine." However, you held that this employment relationship was nonetheless insufficiently pecuniary to fall within Section 51.923, Education Code, as you interpreted it. Section 51.923, as you explained, authorizes higher education institutions to contract with corporations with whom a regent has an actual *ownership interest*, a much greater pecuniary stake than that possessed by the TWU regent, who is a mere employee.

In Opinion No. JC-0426, you did not appear to have before you for consideration several additional factors that would seem to bear upon TWU's ability to maintain its 50-year depository relationship:

- Section 404.0211 of the Government Code. Section 404.0211 allow a bank to serve as a depository for a state agency with whom a bank officer or employee serves as an officers or employee provided certain procedures are followed to guard against a conflict of interest in the agency's selection of the bank.
- Legislative history of the bill that became Section 51.923, Education Code, that suggests the provision was intended to extend to a corporation's employees and officers, not just those with an actual ownership interest in the corporation.
- The facts that (1) the Fifth Circuit has refused to extend the common law conflict of interest doctrine to a mere employment relationship; and (2) apparently no Texas state court has ever done so.
- Recent developments in Texas law that would appear to impact the common law conflict of interest doctrine, including (1) judicial pronouncements endorsing a presumption of eligibility for public officers; (2) legislative modifications of the traditional conflict of interest doctrine; and (3) judicial pronouncements that courts should defer to such legislative policy judgments when fashioning the common law.
- The precautionary measures the regent has taken to prevent any potential conflict of interest involving his bank and TWU. These include (1) the regent's recusal, since the time of his appointment, from any bank work involving TWU; and (2) the bank's impending purchase by a larger, out-of-state bank, which will serve to further insulate TWU's accounts from the regent's potential control or influence.

We would appreciate your clarifying the implications, if any, of these factors on your conclusions in Opinion No. JC-0426. We outline some of these potential implications below.

II. Detailed Discussion

A. Section 404.0211, Government Code

Section 404.0211, Government Code, provides, in relevant part:

> **§ 404.0211. Conflict of Interest**
>
> A bank is not disqualified from serving as a depository for funds of a state agency if:
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> * * *
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> one or more officers or employees of the agency who have the duty to select the agency's depository are officers or directors of the bank or own or have a beneficial interest, individually or collectively, in 10 percent or less of the outstanding capital stock of the bank, if:

> (A) a majority of the members of the board, commission, or other body of the agency vote to select the bank as a depository; and
> (B) the interested officer or employee does not vote or take part in the proceedings.

Thus, if it applies here, Section 404.0211 would appear to permit TWU to maintain its longstanding banking relationship with the bank as long as the regent in question does not, as he has promised, participate in any future board votes to renew that relationship. There are several reasons for concluding that Section 404.0211 would apply here.

Section 404.0211, on its face, applies to a higher education institution like TWU, which is a "state agency."[1] To the extent this creates a conflict with Education Code Section 51.923, Section 404.0211 would appear to control, for at least two reasons. First, Section 404.0211 is addressed specifically to state agency depository relationships, while Education Code Section 51.923 speaks only generally to contracts with corporations.[2] The second reason is the legislative history of the two provisions and the sequence in which they were enacted.

In 1933, the Legislature first enacted a statute authorizing higher education institutions to select depositories for certain public funds maintained at the local level.[3] Over thirty years later, in 1967, the Legislature enacted the statutory predecessor to Government Code Section 404.0211.[4] It was explicitly addressed to "all agencies and political subdivisions of the state":

> Section 1. The selection and qualification of depositories for the deposit of public funds of ***all agencies and political subdivisions of the state*** shall be in accord with the laws now in effect and hereinafter enacted pertaining thereto.
> Section 2. The fact than an employee or officer ***of a state agency or political subdivision***, who is not charged with the duty or selecting the depository thereof, is an officer, director or stockholder of a bank shall not disqualify said bank from serving as the depository of said state agency or subdivision.
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> A bank shall is not be disqualified from bidding and becoming the depository for ***any agency or political subdivision of the state*** by reason of having one or more officers, directors, or stockholders of said bank who collectively own or have a beneficial interest in not more than 10 percent of the bank's outstanding capital stock, and at the same time serves as a member of the board, commission, or other body charged by law with the duty of selecting the depository of such state agency or political subdivision; provided, however, that said bank must be selected as the depository by a majority vote of the members of said

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[1] *See, e.g.,* Tex. Govt. Code § 572.002(10) ("state agency" under ethics statute includes higher education institutions); *see also id.,* § 311.011 (words should be construed according to the rules of grammar and common usage, and consistent with any particular meaning given by legislative definition).
[2] *E.g.,* Tex. Govt. Code § 311.026(b); *cf.* Letter Opinion No. 97-093 (Section 131.903, Local Government Code, which addresses conflicts of interest in the selection of depositories by local governments, controls over the general conflict of interest provisions applicable to local government officials in Chapter 171).
[3] Acts 1933, 43rd Leg., R.S., ch. 221.
[4] Acts 1967, 60th Leg., R.S., ch. 179.

> board, commission, or other body of such agency or political subdivision and no member thereof who is an officer, director or stockholder of the bank shall vote or participate in the proceedings. Common-law rules in conflict with the terms and provisions of this Act are hereby modified as herein provided, but this Act shall never be deemed to alter, change, amend, or supersede the provisions of any home-rule city charter which is in conflict herewith.[5]

In its subsequent enactment of Section 51.923 of the Education Code, as discussed in Part B below, the Legislature did not manifest any intent to change the conflict of interest standards governing selection of depositories, as opposed to those governing contracts generally. The Legislature's chief focus when enacting Section 51.923, rather, was purchasing and research contracts, not depository relationships.

All of these factors suggest that the standards for selecting depositories for state agencies that now appear in Section 404.0211, Government Code, would control over those of Section 51.923, Education Code, to the extent of any conflict.

B. Legislative History of Section 51.923, Education Code

In your discussion of the legislative history of S.B. 1569, the bill that became Section 51.923 of the Education Code, you focus chiefly on the fact that express references to "officers" and "employees" in the original version of the bill were deleted in the Senate Committee Substitute. In light of these changes, you decline to construe Section 51.923 to cover officers and employees, even while you construed it to include persons with much *greater* pecuniary interests, absent "clear legislative intent." A closer examination of the legislative record reveals such intent.

S.B. 1569 was intended to moderate the "strict common-law rule" that had been applied by your office in Opinion No. JM-671 and its progeny to invalidate university contracts "even if the interest [of a regent] is 'de minimis' or minimal."[6] It was aimed chiefly at permitting two types of contracts: (1) contracts that universities had entered into through sealed bid processes; and (2) "purchasing transactions delegated by a Board of Regents to a middle-level employee."[7]

As introduced, S.B. 1569 had applied to all types of contracts entered into by higher education institutions. The amendments made in the Committee Substitute narrowed the scope of the bill to more closely track its primary focus on allowing sealed bid contracts and delegated purchasing contracts between universities and corporations in

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[5] *Id.* (emphasis added).

[6] S.B. 1569, 71st Leg., R.S. House Bill Analysis, at 1.

In Opinion No. JM-671, your office invalidated a research contract between the Texas Agriculture Experiment Station, a subsidiary agency of the Texas A&M system, and an agribusiness corporation on the basis that a system regent owned an indirect interest in the corporation through several layers of subsidiaries.

[7] *Id.*; *Hearing on Tex. S.B. 1569 Before the Senate Committee on Education*, 71st Leg., R.S. (Apr. 19 & May 3, 1989).

which regents had indirect or small interests. But nothing in these amendments was intended to exclude officers or employees from the class of interested persons who are covered by the bill. In fact, the legislative history demonstrates precisely the contrary.

The contemporaneous bill analysis that the Legislature had before it repeatedly reflects its understanding that the Senate Committee Substitute to S.B. 1569, not simply the original introduced version, authorized higher education institutions to enter into contracts where a governing board member is also "a stockholder, *officer*, *employee*, or director or the entity."[8] This is clearly not inadvertent. The bill analysis states this intent even in its "Section-By-Section Analysis," which closely tracks the structure and language of the Committee Substitute, which differed markedly from that of the introduced version.

There is additional evidence of legislative intent that S.B. 1569 extend to governing board members who are officers or employees. As discussed above, the Legislature intended S.B. 1569 to overcome what it viewed as an overly broad and technical application of the common law conflict of interest doctrine to invalidate contracts based on even "de minimis or minimal" interests. The Legislature also intended S.B. 1569 to reconcile the legal requirements regarding conflicts of interest in higher education contracts with Article 6252-9b of the Revised Civil Statutes, the predecessor to Section 572.058 of the Government Code.[9] Article 6252-9b (and later, Section 572.058) permitted state officers with a "personal or private interest" in a matter pending before a board or commission to eliminate the potential conflict by publicly disclosing their interest and recusing themselves.

To conclude that S.B. 1569 does not extend to governing board members who are officers or employees would be inconsistent with these expressions of Legislative intent. It would imply that the Legislature intended to allow members with "de minimis" ownership interests to resolve the conflict by disclosure and recusal, yet intended not to extend this procedure to employees and officers whose pecuniary interests are even more "de minimis." It would likewise undermine the Legislature's efforts to achieve consistency with Article 6252-9b (Section 572.078).

C. Texas Judicial Interpretation of the Common Law Conflict of Interest Doctrine

The proposition that common law conflict of interest principles can invalidate a contract based on a mere employment relationship, while apparently supported by prior opinions of your office, is not supported by Texas court decisions. In the one "on point" Texas case we are aware of, *Crystal City v. Del Monte Corp.*, the Fifth Circuit squarely rejected "the proposition that the mere fact that an officer of a city is also an employee of

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[8] S.B. 1569, 71st Leg., R.S. House Bill Analysis, at 1 - 2. The bill analysis states this intent and understanding in the "Background," "Purpose," and "Section-By-Section Analysis" sections.
[9] *Id.*

a corporation with which the city has contracted is sufficient of itself to invalidate the contract."[10]

Most of your opinions applying the "common law conflict of interest doctrine" derive from a single 1925 "no writ" decision of the Eastland Court of Appeals.[11] The Texas Supreme Court has never authoritatively addressed this doctrine. Of the handful of Texas lower state courts that have applied the doctrine, none have held that a mere employment relationship with a business entity gives rise to an "interest" that could invalidate a contract between the employer and a governmental body.[12] And, again, the Fifth Circuit has rejected that proposition.

These decisions suggest that, if the present issue was actually presented to a Texas court, it would likely hold that the TWU regent, as a mere bank employee, does not have an "interest" sufficient to give rise to a conflict of interest between TWU and his employer.

D. Recent Judicial Pronouncements

This conclusion would be further supported by two sets of recent pronouncements by the Texas Supreme Court.

First, the Texas Supreme Court has given greater deference in recent years to the longstanding principle that restrictions on the right to hold public office should be strictly construed in favor of eligibility.[13] This principle counsels a narrow view of the "interest" required to give rise to a conflict of interest at common law, as well as giving weight to the safeguards that the TWU regent has taken to prevent or eliminate any alleged conflict.

Second, the Texas Supreme Court has indicated that courts should defer to legislative policy judgments embodied in statute when applying common law doctrines. In *Johnson & Higgins of Texas, Inc. v. Kenneco Energy, Inc.*,[14] for example, the Court altered common law prejudgment interest calculation rules it had announced a decade earlier to conform to intervening statutory prejudgment interest standards the Legislature had applied to certain categories of cases.[15] Although the Legislature had not extended its statutory prejudgment interest standards to the types of claims involved in *Kenneco*, the Court nonetheless incorporated these standards into the common law because they

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[10] 463 F.2d 976, 979-80 (5th Cir. 1972), *cert. denied*, 409 U.S. 1023 (1972).
[11] *Meyers v. Walker*, 276 S.W. 305 (Tex. Civ. App.—Eastland 1925, no writ). The two other chief decisions since *Meyers* are *Delta Elec. Constr. Co. v. City of San Antonio*, 437 S.W.2d 602, 609 (Tex. Civ. App.—San Antonio 1969, writ ref'd n.r.e.) and *Bexar County v. Wentworth*, 378 S.W.2d 126 (Tex. Civ. App.—San Antonio 1964, writ ref'd n.r.e.).
[12] *Meyers,* 276 S.W. at 306-08 (payment for trip); *Delta Elec. Constr. Co.*, 437 S.W.2d at 604 (part owner); *Wentworth*, 378 S.W.2d at 128-29 (exclusive sales contract under which councilman received commission on sale of voting machines).
[13] *See, e.g., Brown v. Meyer*, 787 S.W.2d 42, 45 (Tex. 1992) (citing *Hall v. Baum*, 452 S.W.2d 699 (Tex. 1970) and overruling intervening cases).
[14] 962 S.W.2d 507 (Tex. 1998).
[15] *Id.* at 530-31.

provided guidance regarding the appropriate balancing of policy interests sought to be achieved by awarding prejudgment interest.[16]

Kenneco would likewise appear to require Texas courts to modify their application of the common law conflict of interest doctrine in light of intervening statutory developments. These developments include Section 51.923, Education Code, and Section 404.0211, Government Code, discussed above. Both of these provisions embody a legislative policy judgment rejecting a formalistic view of conflicts of interest in favor of one focused on the actual, practical possibility that a given interest will undermine the public trust. A corollary to this more modern view is that the mere existence of an interest should not be an absolute bar but should be capable of being addressed by recusal, disclosure, or other procedures to eliminate the possibility of any conflict arising from that interest. Accordingly, even if a Texas court found that the TWU regent's employment relationship with the bank constitutes an "interest" under the common law conflict of interest doctrine, his recusal from any vote renewing the depository relationship should be deemed to eliminate the problem.

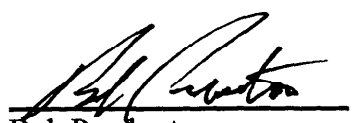
E. Other Factors Preventing Any Conflict of Interest

Finally, under any of the legal standards you ultimately conclude apply, we would ask you to clarify your conclusions in JM-0426 in light of the stringent precautionary measures that the TWU regent has imposed on himself to eliminate any actual or perceived conflict of interest in regard to the university's depository relationship with his employer. In addition to recusing himself from any matters coming before the TWU regents concerning the depository relationship, he has relieved himself of any job responsibilities that relate to TWU. Furthermore, in the imminent future, his employer will be acquired by a larger out-of-state bank. This will remove control and management of bank affairs from local control to a national corporate office, further insulating him from any contact with or control over the depository relationship.

III. Conclusion

The Governor is committed to ensuring that appointees to state boards and commissions comply with the highest ethical standards. We appreciate your efforts to ensure clarity in those standards.

Respectfully submitted,



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[16] *Id.*