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OPINION
OF
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Opinion No. 90-17

BY: Elizabeth A. Glenn
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TO: Honorable James Roger Madalena
State Representative
P.O. Box 255
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QUESTION

Does a state legislator's service on the board of directors of a nonprofit organization:

1. disqualify the organization from obtaining any contracts with state agencies;

2. impede the organization's ability to contract with state agencies; or

3. subject the legislator to liability with regard to such contracting?

CONCLUSION

1. Yes, if a contract was authorized by a law passed during the legislator's term.

2. Yes.

3. Yes.

ANALYSIS:

The first and second questions ask whether having a state legislator on the board of directors of a nonprofit organization prevents the organization from entering into contracts with the state. To answer these questions we must construe N.M. Const. art. IV, § 28 and the state's Conflict of Interest Act, NMSA 1978, §§ 10-16-1 to -15 (Repl. Pamp. 1990). The state constitution provides that a member of the legislature shall not "during the term for which he was elected nor within one year thereafter, be interested directly or indirectly in any contract with the state or any municipality thereof, which was authorized by any law passed during such term." N.M. Const. art. IV, § 28. The Conflict of Interest Act states in pertinent part:

> A state agency shall not enter into any procurement contract for services, construction or items of personal property with a legislator or with a business in which such legislator has a controlling interest, in excess of one thousand dollars ($1,000), where the legislator has disclosed his controlling interest unless the contract is made after public notice and competitive sealed bidding or competitive sealed proposal in accordance with the provisions of the Procurement Code.

NMSA 1978, § 10-16-9 (Repl. Pamp. 1990). Unlike the provisions of N.M. Const. art. IV, § 28, the requirements of Section 10-16-9 apply to all contracts entered into by an interested legislator, not just those authorized by law during the legislator's term.

We believe that N.M. Const. art. IV, § 28 restricts the ability of nonprofit corporations to contract with the state when those corporations have state legislators on their boards of directors. The constitutional restriction imposed on a legislator's contracts applies when three factors are present. First, it applies only during a legislator's term and for one year thereafter. Second, it applies to contracts authorized by law during the legislator's term. New Mexico courts provide some guidance as to when a contract is "authorized by law" for purposes of the constitution, holding that a general appropriations bill alone does not authorize a contract within the meaning of art. IV, § 28. State ex rel. Baca v. Otero, 33 N.M. 310, 267 P. 68 (1928). See also AG Op. No. 88-20 (1988) (New Mexico's rule that an appropriations bill does not authorize a contract differs from that in jurisdictions with similar constitutional limitations). The New Mexico Supreme Court also has ruled that amendments to a statute do not authorize a contract if the unamended statute would have permitted it. State ex rel. Maryland Casualty Co. v. State Hwy.

Comm'n, 38 N.M. 482, 35 P.2d 308 (1934). Based on these cases, one commentator has suggested the following test for determining whether a contract was authorized during a legislator's term of office:

> The test would be whether the contract could have been entered into by the state if the act in question had not been passed. If the answer is "yes," the act had no bearing on the contract and did not authorize it. If the answer is "no," the act made the formation of the contract possible. It permitted and therefore authorized the contract within the meaning of the provision.

Note, Legislative Bodies - Conflict of Interest - Legislators Prohibited From Contracting With State, 7 Nat. Res. J. 296, 302 (1967) (emphasis in original). See also AG Op. No. 88-20 (1988) (legislators could not enter into employment contract with school district for one year after their terms if the contract was authorized by law during their term).

Third, the legislator must have a direct or indirect interest in the contract. As explained by the South Dakota Supreme Court, the purpose of provisions prohibiting legislators from being interested in state contracts is to prevent any clash between personal interests and public duty:

> A member of the state Legislature, by virtue of his office, stands in a fiduciary and trust relation towards the state; in other words, he is the confidential agent of the state for the purpose of appropriating the state's money in payment of the lawful contractual obligations of the state, and it seems to be almost universally held that it is against sound public policy to permit such an agent, or any agent occupying a like position, to himself be directly or indirectly interested in any contract with the state or other municipality, during the period of time of the existence of such trust and confidential relationship. The private interest of such an agent should not become antagonistic to his public duty.

Norbeck & Nicholson Co. v. State, 32 S.D. 189, 197-98, 142 N.W. 847, 849-50 (1913).

Whether a director of a nonprofit organization is sufficiently interested in a contract between the organization and the state to

give rise to the prohibition of N.M. Const. art. IV, § 28 has not been addressed by New Mexico courts. Authority from other jurisdictions, however, indicates that membership on the board of directors of an organization is the type of indirect interest prevented by the constitution. For example, in State ex rel. Smith v. Bohannan, 101 Ariz. 520, 421 P.2d 877 (1966), appeal dismissed, 389 U.S. 1 (1967), the court found illegal a sale of mortgages to the state retirement board because one of the members of the board was president and director of the company from which the mortgages were purchased. According to the decision, this relationship was forbidden because, as director of the company, the state official profited indirectly as the company prospered. 101 Ariz. at 523, 421 P.2d at 880. See also Laconia Hous. & Redevelopment Auth. v. Emanuel, 111 N.H. 253, 281 A.2d 159 (1971) (authorizing sale of land to developer after mayor severed his interest in contract by resigning his positions as director and officer of developer); Scott v. Town of Bloomfield, 94 N.J. Super. 592, 229 A.2d 667 (Super. Ct. Law Div.) (finding lease of municipal property to Boys Club void because mayor was interested in lease as member and director of Club), aff'd on other grounds, 98 N.J.Super. 321, 237 A.2d 297 (Super. Ct. App. Div. 1967), appeal dismissed, 52 N.J. 473, 246 A.2d 129 (1968); Borough of Milford v. Milford Water Co., 124 Pa. 610, 17 A. 185 (1889) (contract for supply of water to borough by a water company of which a majority of the borough's councilmen were directors was void); Miller v. Huntington & Ohio Bridge Co., 123 W. Va. 320, 15 S.E.2d 687 (1941) (upholding payment to bank handling sale of bridge to county court even though member of court was a director of the bank because he was unaware of the arrangement).

Most of these cases involved directors of business corporations whose salaries or other financial benefits were tied to the success of the contracting company. The outcome is not as clear where a public official holds a directorship with a nonprofit organization, particularly if the position is not a salaried one. Some state courts have found that, in order to constitute a conflict, the interest of a public official in a contract must be financial or pecuniary. See, e.g., Panozzo v. City of Rockford, 306 Ill. App. 443, 456, 28 N.E.2d 748, 754 (1940); Gardner v. Nashville Hous. Auth., 514 F.2d 38, 41 (6th Cir.) (conflict of interest refers to a clash between the public interest and the private, pecuniary interest of an individual), cert. denied, 423 U.S. 928 (1975); Yetman v. Naumann, 16 Ariz. App. 314, 317, 492 P.2d 1252, 1255 (Ct.App. 1972) ("interest" refers to a pecuniary or propriety interest, by which a person will gain or lose something). Based on the premise that the disqualifying interest must be pecuniary or proprietary, one court determined that no conflict existed where public officials also served, without compensation, as trustees of a nonprofit corporation. Furlong v. South Park Comm'rs, 340 Ill. 363, 172 N.E. 757 (1930). The court

explained that to invalidate a contract "an interest must be of a personal or private nature, so that an interest incident to membership in an association organized for the public welfare, and not for profit, will not have that effect." 340 Ill. at 370, 172 N.E. at 760.

Other courts have decided that a disqualifying interest need not be one which directly affects the financial well-being of a public officer. In Wilson v. Iowa City, 165 N.W.2d 813, 822 (Iowa 1969), the court stated that conflict of interest principles

> demand complete loyalty to the public and seeks to avoid subjecting a public servant to the difficult, and often insoluble, task of deciding between public duty and private advantage.
>
> It is not necessary that this advantage be a financial one. Neither is it required that there be a showing the official sought or gained such a result. It is the potential for conflict of interest which the law desires to avoid.

(emphasis in original). See also Schaefer v. Berinstein, 140 Cal.App.2d 278, 290, 295 P.2d 113, 122 (Dist. Ct. App. 1956) (public officer's interest need not be a financial one to invalidate the transaction); Low v. Town of Madison, 135 Conn. 1, 5, 60 A.2d 774, 776-77 (1948) (applying standard taking into account policy considerations in which personal pecuniary interest may be only secondarily or incidentally involved). Another case, although it does not address the interest of a director of nonprofit organization, discusses the analogous situation of an unpaid officer of a corporation. In Yonkers Bus, Inc. v. Maltbie, 23 N.Y.S.2d 87, 90 (Sup. Ct.), affirmed, 260 A.D. 893, 23 N.Y.S.2d 91 (App. Div. 1940), the court described, in the context of the case, the nature of an interest in a contract necessary to void a transaction:

> "Interest" in a contract ... has usually been construed as a financial or pecuniary interest. The interest need not, however, be one directly flowing from the contract itself. The general welfare and prosperity of the company of an officer may be an "interest" therein.... If Alderman Slater was in fact merely a nominal officer of the respondent Suburban Bus Co. Inc., and had no interest whatsoever in the progress or prosperity or welfare of the company and received and

> expected to receive no money, as it is contended by this corporation, I suppose that the ordinance would be valid.
>
> Concededly he held the office of president of the corporation. If ... his interest was more than nominal, and he devoted his time and energy to the progress of the corporation, and actively participated in its affairs, it could readily be found he had an interest in it within the prohibition of the statute, although, perchance, he was not a stockholder and, during his occupation of public office, received no salary or other money.

23 N.Y.S.2d at 90 (citations omitted). Although a nonprofit organization, by definition, is not organized to make a profit, it usually performs services in exchange for payment and requires a certain amount of financial security in order to function. Cf. AG Op. No. 88-13 (1988) (nonprofit organization contracting with county or municipality is engaged in business for purposes of gross receipts tax). The Yonkers Bus case suggests that a director of such an organization who actively participates in the affairs of the organization and is interested in its welfare has a sufficient indirect interest to come within the prohibition of N.M. Const. art. IV, § 28. See also M. Kaplan & R. Lillich, Municipal Conflicts of Interest: Inconsistencies and Patchwork Prohibitions, 58 Colum. L. Rev. 157, 180 (1958) ("a directorship alone constitutes an interest in the corporation's contract which would prevent the corporation from doing business with the government served by the director, even if it be shown that he derives no financial benefit from the contract"). We agree with the position expressed in Yonkers Bus. A legislator who actively serves as a director of a nonprofit organization and who has more than a nominal interest in the organization's affairs is faced with the same potential for conflict when the organization contracts with the state as a legislator who receives a personal financial benefit from the contract. Thus, there is just as much reason for subjecting such a legislator to conflict of interest provisions intended to ensure that the public is served by officials whose loyalties are not divided between their public and private interests.

N.M. Const. art. IV, § 28 applies to a legislator's direct and indirect interest in a contract and does not limit disqualifying

interests to those that affect a legislator's personal finances.[1] As indicated above, conflict of interest rules are intended to ensure that a public official discharges his duties "free of influence other than that which may directly grow out of the obligations that he owes the public at large." Schaefer v. Berinstein, 140 Cal.App.2d at 290, 295 P.2d at 122. The interpretation of the constitution consistent with this general goal is that a director of a nonprofit organization, while he may derive no direct personal pecuniary benefit from the organization's contracts, does have an interest in conflict with his role as legislator in the form of a strong incentive to promote the goals of the organization and an indirect interest in the financial welfare of the company. In our opinion, this view, based on a liberal reading of our state's ethics provisions, is the preferred one. Therefore, we conclude that N.M. Const. art. IV, § 28 precludes a nonprofit organization from entering into a contract with the state or a state agency if the organization, within one year of entering the contract, had as a director a member of the legislature and the contract was authorized during that member's term.

In our opinion, the Conflict of Interest Act does not restrict contracts between a state agency and a nonprofit organization solely because the organization has a legislator on its board of directors. The statute's application is limited to contracts between an agency and a legislator or "a business in which such legislator has a controlling interest." A "controlling interest" for purposes of Section 10-16-9 is "an interest which is more than twenty percent." NMSA 1978, § 10-16-2(C) (Repl. Pamp. 1990). Unless a legislator has at least a twenty percent interest in a business, therefore, his position as board member would not affect the ability of the business to contract with state agencies.

In addition, because of how the term "controlling interest" is defined, it appears that Section 10-16-9 of the Conflict of Interest Act does not apply to any contracts involving nonprofit corporations with which a legislator may be associated. Nonprofit

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[1]N.M. Const. art. VI, § 18 disqualifies a judge, absent the consent of the parties, from sitting in a cause "in which he has an interest." Case law has defined the "interest" necessary to disqualify a judge under this provision as "a present pecuniary interest in the result, or actual bias or prejudice, and not some indirect, remote, speculative, theoretical or possible interest." State ex rel. Anaya v. Scarborough, 75 N.M. 702, 410 P.2d 732 (1966). By contrast, N.M. Const. art. IV, § 28 expressly includes indirect interests among those which disqualify a legislator from contracting with the state.

organizations in New Mexico are not permitted to issue shares, NMSA 1978, § 53-8-28 (Cum. Supp. 1989), and there is no other provision for owning interests in them. A nonprofit corporation may have members and may issue certificates evidencing membership. NMSA 1978, § 53-8-11 (Repl. Pamp. 1983). However, these certificates are not indices of ownership. Nonprofit corporations may not pay dividends, and may not distribute their income, profits or assets to their members, directors or officers. NMSA 1978, § 58-8-28 (Cum. Supp. 1989). Because it is impossible to ascertain whether a legislator has a "controlling interest" in a nonprofit corporation, we conclude that the Conflict of Interest Act does not disqualify or restrict a nonprofit organization's ability to enter into contracts with state agencies managed by a board of directors having as one of its members a state legislator.

The third question asks what liability a legislator serving on a nonprofit board may be exposed to if the organization enters into an impermissible contract with a state agency. The constitution does not specify any penalty for violations of N.M. Const. art. IV, § 28. As this office observed in an earlier opinion, however, N.M. Const. art. IV, § 36 provides for impeachment of state officers for crimes, misdemeanors and malfeasance in office, and might be invoked if the conflict of interest provisions were violated. AG Op. No. 65-229 (1965).

In addition, a contract made in violation of N.M. Const. art. IV, § 28 probably would be deemed void. See Armijo v. Cebolleta Land Grant, 105 N.M. 324, 732 P.2d 426 (1987) (contract between land grant and trustee of land grant violated common law conflict of interest principles and was void as against public policy). See also Forrest Currell Lumber Co. v. Thomas, 81 N.M. 161, 164, 464 P.2d 891, 894 (1970) (general rule is that a contract founded on illegal consideration is void). Cf. Thomson v. Call, 38 Cal.3d 633, 646 n.15, 214 Cal. Rptr. 139, 146 n.15, 699 P.2d 316, 323 n.15 (1985) (California courts generally have held that a contract in which a public officer is interested is void, not merely voidable), cert. denied, 474 U.S. 1057 (1986). Recipients of any public money under a void contract would have to refund it to the state. See State ex rel. Callaway v. Axtell, 74 N.M. 339, 363 P.2d 451 (1964).

Another potential source of liability is Section 53-8-25.2 of the Nonprofit Corporation Act, NMSA 1978, §§ 53-8-1 to -99 (Repl. Pamp. 1983 and Cum. Supp. 1989), which provides that a director may be personally liable to the corporation or its members if:

> (A) the director had breached or failed to perform the duties of the director's office...; and

(B) the breach or failure to perform constitutes willful misconduct or recklessness.

Therefore, a legislator and other directors of a nonprofit organization may be found liable for damages for breach of fiduciary duty if they intentionally enter into a contract which is invalid under N.M. Const. art. IV, § 28.

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