

Conflicts of Interest Involving Members of Local Authorities

Presentation to the 4th Annual LexisNexis Local Government Legal Forum

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7 April 2005*

This paper discusses the law about conflicts of interest for members of local authorities. The Auditor-General has a role in administering the law in this area.¹

Impartiality and transparency in administration are essential to maintaining the integrity of the public sector. Where activities are funded by public money, or are undertaken in the public interest, taxpayers (and, in the local government sector, ratepayers) will have strong expectations of probity. Media and the public take a strong interest when they think public funds are being spent irresponsibly or misused for private gain.

Accordingly, members of local authorities need to take great care to avoid situations where they could be accused of using their public office to further their personal interests. The consequences – both legal and reputational – can be severe.

Conflicts of interest and local authorities

A conflict of interest exists where two different interests are at odds. For a member of a local authority, a conflict of interest arises when his or her responsibilities as a member of the local authority could be affected by some other separate interest or duty that he or she may have in relation to a particular matter. That other interest or duty might exist because of:

- a relationship or role that the member has; or
- something he or she has said or done.

The law applies differently to pecuniary (that is, financial) and non-pecuniary conflicts of interest. Members and their advisers need to consider the potential for both types of conflict of interest. Different rules apply to each type:

- pecuniary interests are largely governed by the Local Authorities (Members' Interests) Act 1968 ("the Act");
- non-pecuniary conflicts of interest are governed by the common law rule against bias.²

¹ Or at least part of it. See below.

² Of course, the common law rule against bias can apply to pecuniary interests too, but I will consider pecuniary interests only in the context of the Act.

Because I am addressing an audience largely comprised of lawyers, I will not spend time explaining at a high level the meaning – and importance – of the legal concept of bias.³ Rather, I will explain my Office’s role in relation to the law, and discuss in detail our understanding of how the law applies, in practice, to members of local authorities.

I will address pecuniary and non-pecuniary conflicts of interest separately.

Why is the Auditor-General mixed up in all this?

Our role in relation to pecuniary interests

The Office of the Auditor-General carries out the primary statutory functions under the Local Authorities (Members’ Interests) Act.

Our role in administering the Act includes:

- deciding applications for approval of a member’s interest in contracts worth more than \$25,000 in a financial year;
- deciding applications for exemptions or declarations from the rule against members discussing and voting where they have a pecuniary interest;
- providing guidance to local authority members and officers, to help them comply with the Act in particular situations; and
- investigating and prosecuting alleged offences against the Act.

We do not issue “rulings” about whether a member has a pecuniary interest in a particular matter; nor about whether the Act has been breached. Only the courts can determine those matters.

Our role in relation to non-pecuniary conflicts of interest

Because of our role under the Act, people often come to us seeking guidance about issues that turn out not to be about pecuniary interests, but nevertheless may raise questions about conflicts of interest more generally – that is, of a non-pecuniary sort.

We have no formal decision-making role in respect of non-pecuniary conflicts of interest. In particular, we do not have the power to grant exemptions in this area.

³ Interested readers who want to study recent cases that examine the nature of the legal test for bias can refer to *Zaoui v Greig* (HC, Auckland, CIV-2004-404-000317, 31 Mar 2004, Salmon & Harrison JJ); *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); *Auckland Casino Ltd v Casino Control Authority* [1995] 1 NZLR 142 (CA); *R v Gough* [1993] AC 646 (HL). Summaries of a number of cases involving local authorities are contained in Appendices B and C of our Office’s *Conflicts of interest* publication (see below).

However, as the auditor of all local authorities,⁴ we have an interest in encouraging them to carry out their activities lawfully and responsibly. As part of this role, we may be able to offer guidance about situations where a non-pecuniary conflict of interest could exist. We may also look into matters of probity involving a member of an authority, which could include inquiring into and reporting on whether a member failed to declare a conflict of interest.⁵

Our guidance

The principal way in which we assist members of local authorities to comply with the law is by publishing a guide that sets out our understanding of the law about conflicts of interest and our expectations of members. This publication is *Conflicts of interest: a guide to the Local Authorities (Members' Interests) Act 1968 and non-pecuniary conflicts of interest*.⁶ It explains in detail the legal requirements that apply to members, and offers practical guidance for dealing with particular situations.

The Local Authorities (Members' Interests) Act 1968

The Act governs the pecuniary interests of members of local authorities. It:

- controls the making of **contracts** worth more than \$25,000 in a financial year between members and their authority; and
- prevents members from **discussing and voting** on matters before the authority in which they have a pecuniary interest, other than an interest in common with the public.

The Act applies to members of city councils, district councils, regional councils, community boards, and a range of other public bodies.⁷

The Act regulates the actions of individual members of authorities, not the actions of the authorities themselves. Members, not authorities, may be prosecuted for breaches of the Act.

The Act contains provisions that set out when a person who is associated with a company is deemed to share any pecuniary interests of that company.⁸

⁴ The Auditor-General is the auditor of all "public entities". This term is defined in s 5 of the Public Audit Act 2001.

⁵ Our general audit and inquiry functions and powers are set out in Parts 3 and 4 of the Public Audit Act 2001. See especially ss 16 and 18.

⁶ Which I will refer to as *Conflicts of interest*. This publication is available in hard copy from our Office, or on our website at www.oag.govt.nz. The current edition was published in August 2004.

⁷ The First Schedule to the Act specifies the full list of bodies that are subject to the Act. The discussing and voting rule in the Act also applies to members of committees of those authorities (regardless of whether a committee member is also a member of the authority itself). The Act does *not* apply to council-controlled organisations, port companies, airport companies or energy companies.

⁸ See ss 3(2) and 6(2). The most common example is where the member has a 10% (or greater) shareholding in the company. If a member has an interest in a company which falls short of the requirements of the deeming provisions, then we take the view that they are deemed *not* to share the company's pecuniary interests. However, quite apart from the question of a deemed interest, the

A member can also have a deemed pecuniary interest through their spouse.⁹

The contracting rule

Section 3(1) of the Act provides that a member of the local authority is disqualified from office who is concerned or interested¹⁰ in contracts with the authority under which the total payments made, or to be made, by or on behalf of the authority exceed \$25,000 in any financial year, unless approval has been obtained from the Auditor-General.¹¹ I will refer to this provision as **the contracting rule**.

If the contracting rule applies to disqualify a member, it is an offence for the person to continue to act as a member of the local authority.¹² The validity of the contract(s) is unaffected.

The \$25,000 limit relates to the value of all payments made in respect of all contracts, in which the member is interested during the financial year. It does not apply separately to each contract; nor is it just the amount of the profit the contractor expects to make or the portion of the payments to be personally received by the member. The contracting rule also applies to subcontracts.¹³

Getting approval to exceed the limit

The Act allows the Auditor-General to grant prior approval and, in limited cases, retrospective approval, of a member's interest in contracts, which has the effect of suspending the contracting rule in relation to that case.

An application for prior approval can be granted where a "special case" exists.¹⁴

The test for retrospective approval is more difficult. We can only grant retrospective approval (that is, where the statutory payment limit has already been breached) if we are satisfied that:

- there is sufficient special reason why prior approval was not obtained; and
- prior approval would have been obtained if it had been sought.¹⁵

We can grant approvals in respect of either a large a single contract, or multiple small contracts that are of the same or similar type (such as day-to-day purchases of

member may sometimes have a separate *personal* pecuniary interest in a matter concerning a company (for instance, if the member is a shareholder in the company and the matter is so significant to a company that it is likely to materially affect the company's share price, or if the member is a paid director and that matter is likely to materially affect their remuneration).

⁹ See ss 3(2A) and 6(2A). From 13 October 2007, the spousal deeming provisions will also apply to civil union partners and de facto partners: see the Relationships (Statutory References) Act 2005.

¹⁰ This term means concerned or interested in a pecuniary sense: *Hogg v Fowler (Controller and Auditor-General)* [1938] NZLR 104.

¹¹ Some other statutory exceptions also exist: see s 3(3).

¹² S 5.

¹³ See s 3(3)(b).

¹⁴ S 3(3)(a).

¹⁵ S 3(3)(aa).

supplies), up to a particular value. Where the approval relates to an ongoing arrangement, our usual practice is to grant approval for only one financial year at a time.

We consider that the contracting rule is not intended to prevent elected members from ever contracting with their local authority. We recognise that there will sometimes be occasions when it is both fair and justifiable for a local authority to contract with a member (or his or her business). Rather, in our view the legislative intention is to ensure that if this is to occur, it is handled in a fair and transparent manner, and that the local authority is able to justify its decision to do so. This is important, in order to avoid the perception that a member's official position may have resulted in undue influence or preferential treatment. Accordingly, we carefully scrutinise the process followed by a local authority, and the reasons for its decision, when considering an application to approve a contract in which a member of a local authority is interested.

Our *Conflicts of interest* publication provides further information about the process that local authorities should follow when seeking approval of a member's interest in contracts, and our general approach to assessing such applications.¹⁶

Affected members and their authorities will need to work together to monitor contracting situations, and arrange for any necessary applications to be made. We encourage local authorities to establish a register of members' interests to facilitate compliance with the contracting rule. If the register is updated regularly, and relevant staff are aware of it, the register should help identify situations where contracts should not be entered into without our approval.

The discussing and voting rule

Section 6(1) of the Act prohibits a member of a local authority or its committees from discussing or voting on a matter before the authority in which the member has a pecuniary interest (other than one in common with the public), unless any of the statutory exceptions apply. I will refer to this provision as **the discussing and voting rule**.

Breach of the discussing and voting rule constitutes an offence, and a conviction results in vacation of office.¹⁷

What is a pecuniary interest?

The Act does not define the term "pecuniary interest".¹⁸ The test we use is:

¹⁶ See pages 17-21 of that publication.

¹⁷ S 7.

¹⁸ Judicial decisions that consider pecuniary interests include *Collinge v Kyd* (HC, Auckland, CIV-2004-404-004828, 15 Sep 2004, Paterson J); *Auditor-General v Christensen* [2004] DCR 524; *Locabail (UK) v Bayfield Properties* [2000] 1 All ER 65; *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); *Calvert v Dunedin City Council* [1993] 2 NZLR 460; *NZI Financial Corporation v NZ Kiwifruit Authority* [1986] 1 NZLR 159; *Loveridge v Eltham County Council* (1985) 5 NZAR 257; *Re Guimond and Sornberger* (1980) 115 DLR (3rd) 321; *Meadowvale Stud Farm v Stratford County Council* [1979] 1 NZLR 342; *Attorney-General v Linnell* (Magistrate's Court, Hastings, 23 July 1976, Dougall SM); *Downward v Babington* [1975] VR 872; *Re Wanamaker*

whether, if the matter were dealt with in a particular way, discussing or voting on that matter could reasonably give rise to an expectation of a gain or loss of money for the member (or company or spouse) concerned.¹⁹

Pecuniary interests can be indirect. They can include such things as effects on property value, or financial effects on a business.

Any question about whether a pecuniary interest exists needs to be considered by reference to the nature of the particular matter (that is, the proposal, question, report, or motion) being discussed at the meeting. It is often not possible to say whether a member has a pecuniary interest in all matters concerning a general subject.

Interests in common with the public

If the member's pecuniary interest can be said to be "in common with the public", he or she will not be caught by the discussing and voting rule.

It can be tricky to assess whether an interest is in common with the public. We suggest considering whether the interest is:

- of a different *nature or kind* to that of other people, or
- significantly different in *size*.

Another way is to ask whether the matter affects the member in a different way, or to a materially greater degree, than most other people.

Some other exceptions to the discussing and voting rule are also set out in the Act.²⁰

Exemptions and declarations

In some situations where a member has a pecuniary interest in a matter, the Act allows the Auditor-General to grant an exemption²¹ or declaration,²² which has the effect of suspending the discussing and voting rule in relation to the specified matter:

- Under s 6(3)(f), we can grant an exemption from the discussing and voting rule if we are satisfied that the pecuniary interest is so remote or insignificant

and Patterson (1973) 37 DLR (3rd) 575; *Auditor-General v Love* (1967) 12 MCD 64; *Attorney-General v Pearce* [1963] NZLR 459; *Rands v Oldroyd* [1959] 1 QB 204; *Brown v DPP* [1956] 2 QB 369; *Hogg v Fowler (Controller and Auditor-General)* [1938] NZLR 104; *R v Hendon RDC ex p Chorley* [1933] 2 KB 696; *Dimes v Proprietors of Grand Junction Canal* (1852) 3 HL Cas 759 (HL). Although many of these cases directly concerned local authorities, most of them were civil cases, not prosecutions under the Act. Summaries of several of the above cases are contained in Appendix B of our *Conflicts of interest* publication. Of the New Zealand judgments listed above, only the *Christensen* and *Love* cases were prosecutions for an offence against the discussing and voting rule. The *Linnell*, *Pearce* and *Hogg* cases concerned the contracting rule.

¹⁹ This is adapted from the Victorian case of *Downward v Babington* [1975] VR 872.

²⁰ S 6(3).

²¹ S 6(3)(f).

²² S 6(4). The only real difference between an exemption and a declaration is that the law requires each of them to be granted on different legal grounds.

that it cannot reasonably be regarded as likely to influence the member when voting or taking part in the matter.

- Under s 6(4), we can grant a declaration that the discussing and voting rule will not apply if we are satisfied that applying the discussing and voting rule to this matter:
 - would impede the transaction of business of the local authority; or
 - would otherwise not be in the interests of the local authority's district or its electors or inhabitants.

An exemption or declaration will always state clearly the matter to which it relates. It is not a general suspension of the pecuniary interest rule. However, a separate application does not necessarily have to be sought in respect of each meeting. We can grant exemptions or declarations for a matter that is likely to arise on an ongoing basis, but we need to be able to define it with sufficient specificity.

Requests for an exemption or declaration can arise in many different circumstances, so we have to consider each application on its own merits. We sometimes seek the views of the local authority's chief executive and mayor about an application, and/or comments from other members of the authority or members of the public who have an opinion on the matter. Our *Conflicts of interest* publication discusses the factors that are most often relevant when we assess an exemption or declaration application.²³

How should a member comply with the discussing and voting rule?

When the discussing and voting rule applies, the member must not participate in the authority's discussions and voting on the matter. The Act also requires the member to declare the pecuniary interest at relevant meetings and for the minutes to record the declaration of interest and abstention.²⁴

Ultimately, we think the member concerned has to exercise their own judgment as to whether or not they think they have a pecuniary interest in any given matter. The individual member will usually have the fullest information about the nature and extent of their own activities and financial interests, and how he or she may be connected to or affected by any particular matter as and when it comes before the local authority. The member may be assisted by seeking advice from others, but we consider it is not the responsibility of the chair, chief executive or Office of the Auditor-General to "rule" on whether a pecuniary interest exists in a particular case.

In the interests of openness and fairness (and to minimise the risk to members of having to defend themselves against a formal complaint about their participation), we encourage members to take a cautious approach to such issues and, if in doubt, to declare an interest and abstain from discussing or voting on the matter.

²³ See pages 32-35 of that publication.

²⁴ S 6(5).

Non-pecuniary conflicts of interest

Non-pecuniary conflicts of interest are outside the scope of the Act, and are not often the subject of investigation by the our Office. However, we are increasingly asked by local authority members and officers for guidance about such conflicts.

Under the common law about bias, the potential legal risk is not personal criminal liability on the part of the member, but the validity of the local authority's decision if it is challenged in the courts by way of an application for judicial review.²⁵

The local authority context

We do not think the law about bias needs to be applied in an unrealistically strict fashion in the local authority context. There is some scope for granting greater leeway to members of local authorities than to, say, judges.

We think that, in general, the courts recognise that local authorities are different in nature from other decision-making bodies. In particular, they acknowledge that where Parliament entrusts a function to an elected or political body (instead of to a tribunal or a court), it is natural to expect that:

- the members of the authority will bring their own experience and knowledge to the decision-making process;
- the members may already have views – even strong or publicly stated views – about the matter; and
- political considerations may play a part in the decision.

We think the courts will also take into account the type of function being exercised. They are likely to take a stricter approach with decisions that directly affect the legal rights, interests and obligations of an individual or small group of individuals (as opposed to decisions with a large policy or political element).

Types of non-pecuniary conflicts of interest

In our experience, the most common risks of bias through a non-pecuniary conflict of interest arise where:

²⁵ Appendix C of our *Conflicts of interest* publication contains summaries of several court cases about non-pecuniary conflicts of interest. It includes *Man O'War Station v Auckland City Council (No 1)* [2002] 3 NZLR 577 (PC); *Riverside Casino v Moxon* [2001] 2 NZLR 78 (CA); *R v Bow Street Metropolitan Stipendiary Magistrate, ex parte Pinochet Ugarte (No 2)* [1999] 2 WLR 272 (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; *R v Reading Borough Council ex parte Quietlynn* (1986) 85 LGR 387; *R v Amber Valley District Council, ex parte Jackson* [1984] 3 All ER 501; *Meadowvale Stud Farm v Stratford County Council* [1979] 1 NZLR 342; *Anderton v Auckland City Council* [1978] 1 NZLR 657; *Frome United Breweries v Bath Justices* [1926] AC 586; *English v Bay of Islands Licensing Committee* [1921] NZLR 127; *R v Halifax Justices, ex parte Robinson* (1912) 76 JP 233. Many of these cases involved local authorities.

- the member's statements or conduct indicate that he or she has **predetermined** the matter before hearing all relevant information (that is, the member has a "closed" mind); or
- the member has a close **relationship** or involvement with an individual or organisation affected by the matter.

Our *Conflicts of interest* publication discusses these two types of non-pecuniary conflicts of interest, and sets out our view of a range of common factual scenarios.²⁶ I outline some of our observations below.

Bias through predetermination

We think it is unacceptable for a member to participate in the authority's consideration of a matter if he or she:

- makes statements that suggest that his or her mind is made up about the particular matter before having heard all views, or that the member's position is so fixed that he or she is unwilling to fairly consider the views of others, or that the member is not prepared to be persuaded by further evidence or argument;
- refuses to read or listen to reports or submissions presented to the authority about the matter; or
- has made a formal submission to the authority in his or her personal capacity, to support or oppose a particular proposal, as part of a public submissions process.

However, we think the law does not prevent members from:

- discussing issues and exchanging ideas with members of the public;
- promoting a particular view during debate around the meeting table; or
- advocating opinions or policies in public – or campaigning for election – about issues of public interest (so long as the conduct does not indicate that the member has already closed their mind to further consideration of a particular matter).

Bias through relationships

In assessing whether bias arises through a relationship, we suggest that a member should consider both:

- the extent of his or her personal links or involvement with the other person or group; and
- the degree to which the matter under discussion directly affects that person or group.

To give some examples, we think it is unacceptable to participate in the authority's consideration of a matter if:

²⁶ See pages 39-50 of that publication.

- the decision directly affects one of the member's immediate family or a close friend; or
- one of the member's immediate family has made a submission about the matter.

We think it is unwise to participate in consideration of a matter before the authority concerning a club or similar organisation that the member belongs to if:

- the member is an executive officeholder or trustee, or are otherwise strongly publicly identified with the club; or
- the matter specifically and significantly concerns the club – such as a proposed grant of money to the club, or something else directly affecting the club's finances or property.

If the matter concerns the member's employer, we think it is unwise to participate if:

- the member is a senior executive (particularly where the matter directly concerns the organisation); or
- the member is personally involved in the issue as part of his or her employment.

For our discussion of some other situations, see our *Conflicts of interest* publication.²⁷

An issue of perception

As with pecuniary interests, a member who has a non-pecuniary conflict of interest in a matter at a meeting should ensure that his or her interest is declared and recorded in the minutes, and that he or she does not discuss or vote on the matter.

The application of the law in this area always involves questions of judgment and degree. The legal test is, of course, not limited to actual bias, but relates to the appearance or "danger" of bias. Members need to be encouraged to bear in mind issues of perception, in terms of how others may see the situation. The fact that the member is acting in good faith and with the best of motives is rarely in doubt, but it is of course not relevant to the law that the member genuinely believes themselves to be unbiased. And in politics, of course, the merest perception of impropriety can be extremely damaging, whether or not a court would ultimately find the member's actions to be lawful. The safest advice is always "if in doubt, stay out".

Beyond the law lies ethics

Our *Conflict of interest* publication focuses on the legal obligations of members of a local authority in formal decision-making at authority meetings. Yet 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.

²⁷ Pages 39-50.

For instance, where a problem arises outside the confines of formal decision-making at a local authority meeting, or where a problem relates not to a member but instead to an employee, there may be no doubts over legality, but the situation may nevertheless be questionable.

Accordingly, local authorities and their advisers also need to carefully consider how to manage the ethical dimensions of conflicts of interest.

For members of local authorities, one way in which the ethical dimension may be managed is through the code of conduct adopted under the Local Government Act 2002.

Our November 2004 report, *Christchurch Polytechnic Institute of Technology's management of conflicts of interest regarding the Computing Offered On-Line (COOL) programme*,²⁸ while not concerned specifically with local government, examines the nature of public sector conflicts of interest in that broader ethical context. It sets out what the Auditor-General considers to be generally accepted expectations when conflicts of interest arise in relation to a person working for a public entity.

²⁸ This report is also available from our Office, or our website. See in particular the Foreword, Part Two, and Appendix 1.