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## **HB 1170 Conflict of Interest - Disclosure Requirements Legislation**

### *Questions and Answers*

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This Q n A is designed to help school boards and administrators navigate through HB 1170 which amended and clarified the complex and rather confusing language of HB 1214 (SDCL Ch. 3-23) which was enacted in 2016. The law requires school board members, business managers, chief financial officers, superintendents, chief executive officers, and any other person<sup>1</sup> with the authority to enter into a contract or spend money in an amount greater than five thousand dollars, or multiple contracts in an amount greater than five thousand dollars with the same party within a twelve-month period, to disclose their personal interest in any contract between their school district and a third party.

The opinions expressed below as to the application of HB 1170 are solely those of ASBSD and should not be considered as legal advice. Schools need to consult their local school attorneys on how to comply with SDCL Ch. 3-23 as amended by HB 1170.

HB 1170, Section 10, amended SDCL 3-23-6 to read:

“3-23-6. No board member, business manager, chief financial officer, superintendent, chief executive officer, or other person with the authority to enter into a contract or spend money in an amount greater than five thousand dollars of a local service agency, school district, cooperative education service unit, education service agency, nonprofit education service agency, or jointly governed education service entity that receives money from or through the state may have an interest in a contract nor receive a direct benefit from a contract in amount greater than five thousand dollars or multiple contracts in an amount greater than five thousand dollars with the same party within a twelve-month period to which the local service agency, school district, cooperative education service unit, or education service agency is a party except as provided in § 3-23-8.”

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<sup>1</sup> For the balance of the Q n A, the phrase “*School Official*” will be used when referring to persons to whom the conflict of interest law applies, i.e., school board members, business managers, chief financial officers, superintendents, chief executive officers, and any other person with the authority to enter into one or more contracts in an amount greater than five thousand dollars within a twelve-month period.

SDCL 3-23-6 refers to a *School Official* who has “an interest in a contract” (which we interpret to mean an indirect interest in a contract) and a *School Official* who has a “direct benefit from a contract.” The law requires that a person who has an interest in a contract to disclose that interest. A person who derives a benefit from a contract must disclose that benefit and also the governing board must authorize the person to derive the direct benefit from the contract. It is also important to note that the new law requires disclosure of an interest in a contract or when a person derives a direct benefit from a contract **only** if the contract has a value of more than \$5,000 or multiple contracts in an amount greater than \$5,000 with the same party within a twelve-month period. The rules applicable to “interest in a contract” and “derive a benefit from a contract” are addressed more fully below.

View the conflict of interest law as a triangle. One point on the triangle is the school district. The second point on the triangle is a *School Official*. The third point is a 3<sup>rd</sup> party (person or entity) which has a contract with the school district. One side of the triangle connects the school district to the *School Official*. The second side of the triangle connects the school district with the 3<sup>rd</sup> party (person or entity) through some type of contractual relationship between the school district and 3<sup>rd</sup> party. The third side of the triangle connects the *School Official* to the 3<sup>rd</sup> party by having an interest in the contract in or deriving a direct benefit from the contract between his/her own school district and the 3<sup>rd</sup> party.

## QUESTIONS AND ANSWERS

1. What is meant by “or other person with the authority to enter into a contract or spend money in an amount greater than five thousand dollars” and what would be examples?

**ANSWER:** Persons other than the superintendent and business manager and the school board may have been given authority by the board to enter into contracts and spend school district funds. For example, certain employees may have been authorized to use a school district credit card or sign vouchers, purchase orders or contracts on behalf of the school district. The disclosure laws would apply to those people.

2. What is meant by “multiple contracts in an amount greater than five thousand dollars with the same party within a twelve-month period?”

**ANSWER:** “Multiple contracts in an amount greater than five thousand dollars with the same party within a twelve-month period” means there is more than one sales/purchase transaction, voucher, purchase order or other contract between the school district and a third party and the *School Official* has an interest in or receives a direct benefit from those contracts. If those multiple contracts transpire within a one year period the person must disclose to the school board their interest in the contract. One year refers to a 12 month period, not a calendar year and not a school fiscal year.

3. The law says no *School Official* may have an interest in a contract that the school district is a party to unless disclosure is given and the interest is authorized by the school board. What is meant by “an interest in a contract” and when does it apply?

**ANSWER:** HB 1170, Section 12 says a *School Official* has an interest in a contract entered into by his/her school district and a third party if the person, the person's spouse, or any other person with whom the person lives and commingles assets and (1) the person, the person's spouse, or any other person with whom the person lives and commingles assets, is employed by a party to any contract with the local service agency, school district, cooperative education service unit, or education service agency; or (2) the person, the person's spouse, or any other person with whom the person lives and commingles assets, receives more than nominal

compensation or reimbursement for actual expenses for serving on the board of directors of an entity that derives income or commission directly from the contract or acquires property under the contract.

Section 12 of HB 1170 amended SDCL Ch. 3-23 by adding the following statutory provision:

“A person described in § 3-23-6 has an interest in a contract if the person, the person's spouse, or any other person with whom the person lives and commingles assets:

- (1) Is employed by a party to any contract with the local service agency, school district, cooperative education service unit, or education service agency; or
- (2) Receives more than nominal compensation or reimbursement for actual expenses for serving on the board of directors of an entity that derives income or commission directly from the contract or acquires property under the contract.”

4. What does a person who only has an interest in a contract have to do in order to comply with the law?

**ANSWER:** (a) Section 14 of HB 1170 states a *School Official* who has an interest in a contract must disclose the existence of a contract in which the person has an interest and the person's role in the contract.

(b) The law does not expressly state there must be written disclosure of an interest in a contract. ASBSD recommends that the disclosure of an interest in a contract be in writing.

(c) The law refers to disclosure of the existence of a contract in which the person has an interest and the person's role in the contract. ASBSD recommends that the same five things which are required in a disclosure of a direct benefit be included in the disclosure of an interest in a contract: (i) all parties to the contract, (ii) the person's role in the contract, (iii) the purpose or objective of the contract, (iv) the consideration or benefit conferred or agreed to be conferred upon each party, and (v) the duration of the contract;

(d) The law says that disclosure of an interest in a contract be made at the annual reorganization meeting if the contract extends into consecutive fiscal years. ASBSD recommends that the same time frame applicable to disclosure of a direct benefit be used for disclosing an interest in a contract, i.e., disclosure should be given prior to entering into any contract that requires disclosure or within forty-five days after entering into the contract that requires disclosure, and if the contract extends into consecutive fiscal years, disclosure shall be made at the annual reorganization meeting.

(e) Section 14 of HB 1170 says that no governing board authorization is required after a person discloses an interest in the contract.

(f) The interest disclosure must be included in the official minutes of the governing board. The official minutes are not required to be sent to the auditor-general and attorney general.

5. The law says no *School Official* may derive a direct benefit from a contract that the school district is a party to unless disclosure is given and direct benefit is authorized by the school board. What is meant by “derive a direct benefit” ? .

**ANSWER:** HB 1170, Section 11 says that in order for a *School Official* to receive a direct benefit from a contract between his/her school district and a third party, the person, the person's spouse, or any other person with whom the person lives and commingles assets (1) must be a party to or intended beneficiary of the contract, (2) must have more than a five percent ownership interest in an entity that is a party to the contract, (3) must acquire property under the contract; or (4) or must receive compensation, commission, promotion, or other monetary benefit directly attributable to any contract.

Section 11 of HB 1170 identifies what is meant by “derives a direct benefit from a contract:

“3-23-7. A person described in § 3-23-6 derives a direct benefit from a contract if the person, the person's spouse, or any other person with whom the person lives and commingles assets:

- (1) Is a party to or intended beneficiary of any contract held by the local service agency, school district, cooperative education service unit, or education service agency;
- (2) Has more than a five percent ownership interest in an entity that is a party to any contract held by the local service agency, school district, cooperative education service unit, or education service agency;
- (3) Acquires property under the contract; or
- (4) Will receive compensation, commission, promotion, or other monetary benefit directly attributable to any contract with the local service agency, school district, cooperative education service unit, or education service agency.”

7. What does a person who derives a direct benefit from a contract have to do in order to comply with the law?

**ANSWER:** (a) The law states that a *School Official* may derive a direct benefit from a contract that the school district is a party to the contract if disclosure is given and the direct benefit is authorized by the school board. Section 14, subsection (1) of HB 1170 specifically states the disclosure of a direct benefit must be in writing.

(b) Section 14, subsection (1) of HB 1170 lists five things which must be identified in the disclosure of a direct benefit: (i) all parties to the contract, (ii) the person's role in the contract, (iii) the purpose or objective of the contract, (iv) the consideration or benefit conferred or agreed to be conferred upon each party, and (v) the duration of the contract;

(c) HB 1170, Section 14 says that any person receiving a direct benefit from a contract and requesting an authorization pursuant to § 3-23-8 shall make the request prior to entering into any contract that requires disclosure or within forty-five days after entering into the contract that requires disclosure. Any authorization by the governing board requires no further disclosure or authorization unless the contract extends into consecutive fiscal years. If the contract extends into consecutive fiscal years, disclosure shall be made annually at the annual reorganization meeting.

8. What must the governing board do when a disclosure is presented which relates to a person deriving a direct benefit from a contract?

**ANSWER:** (a) After the governing board receives a disclosure of a direct benefit, the governing board must review the disclosure and decide if the terms of the contract are fair and reasonable, and if the contract is contrary to the public interest.

(i) If the governing board determines the contract terms from which a direct benefit is derived are fair and reasonable, and that the contract is not contrary to the public interest, the governing board would vote to authorize (approve) the person deriving a direct benefit from the contract. After the governing board authorizes a person to derive a direct benefit from a contract, no further disclosure or authorization related to the contract is required unless the contract extends into consecutive fiscal years. If the contract extends into consecutive fiscal years, disclosure must be made at the annual reorganization meeting but no new authorization is required. [HB 1170, Section 14]

(ii) If the governing board determines the contract terms from which a direct benefit is derived are not fair and reasonable, or is contrary to the public interest, the governing board would vote to not authorize (not approve) the person deriving a direct benefit from the contract. If the governing board rejects any request for authorization, the contract is voidable and subject to disgorgement (i.e., the act of giving up on demand or by legal compulsion something that was obtained by illegal or unethical acts) or the person may resign from the local service agency, school district, cooperative education service unit, or education service agency. [HB 1170, Section 14]

(b) If the person provided full written disclosure, the governing board reviewed the essential terms of the transaction or contract and the person's role in the contract or transaction, and the transaction or the terms of the contract are fair, reasonable, and not contrary to the public interest, the governing board must authorize (approve) the person's deriving a direct benefit from the contract. The school board should carefully review and consider each disclosure and decide if the terms of the contract are fair, reasonable, and not contrary to the public interest. If a governing board voted to deny that authorization, that decision of the governing board may be appealed into circuit court.

(c) After the governing board acts on the disclosure of a direct benefit, the disclosure and governing board action become part of the public record. The official minutes of the governing board must include the governing board action on each disclosure and request for authorization to derive a direct benefit from a contract. A copy of the official governing board minutes must be sent to the Auditor-General and Attorney General. The law refers to official minutes, so the governing board must approve the minutes from the meeting when the disclosure was presented to the board and acted upon by the board before the minutes are sent to the Auditor-General and Attorney General. The law does not specify whether the minutes can be emailed or sent through first class mail. The Auditor-General has indicated that the minutes should be emailed.<sup>2</sup> The Attorney General's Office has indicated the minutes should be either emailed or mailed to the AG's office.<sup>3</sup> Also, the law does not give a time frame within which the minutes must be sent, but it should be sent within thirty (30) calendar days of the board meeting when the minutes were approved. (Although the minutes reflecting disclosure of an interest in a contract are not required to be sent to the Auditor-General and Attorney General, if disclosure of a direct benefit was acted on by the governing board at the same board meeting the entire minutes of course would be sent). [HB 1170, Section 14, subsection(3)]

(d) The law specifically states "no board member of a local service agency, school district, cooperative education service unit, or education service agency may participate in or vote upon a decision of a local service agency, school district, cooperative education service unit, or education service agency relating to a matter in which the member derives a direct benefit." [HB 1170, Section 14]

**9. Are there any exceptions to the disclosure requirements?**

**ANSWER:** Yes. Section 13 of HB 1170 added a new statutory provision which states a person does not have an interest in a contract and does not derive a direct benefit from a contract in eight different situations. If any of the following apply, the school board member, chief financial officer, superintendent, chief executive officer, or other person with the authority to enter into a contract on behalf of the school district would not have an interest in the contract or derive a direct benefit from a contract, and therefore disclosure (and authorization, if a direct benefit) is not required:

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<sup>2</sup> Minutes should be emailed to Legislative Audit at Sheri.Doolittle@state.sd.us .

<sup>3</sup> ASBSD does not have an email address at this time at the AG's where minutes may be emailed; ASBSD will let member schools know as soon as possible an email address at the AG's office where the minutes should be emailed. Printed copies of the minutes should be mailed to the Attorney General's Office, 1302 E. Hwy. 14 #1, Pierre, SD 57501.

(1) when the person's relationship to the contract is based solely on the value associated with the person's publicly-traded investments or holdings, or the investments or holdings of any other person with whom the board member, business manager, chief financial officer, superintendent, or chief executive officer lives or commingles assets;

(2) when the person's relationship to the contract is due to participating in a vote or a decision in which the person's only interest arises from an act of general application;

(3) when the person's relationship to the contract is due to the person receiving income as an employee or independent contractor of a party with whom the local service agency, school district, cooperative education service unit, or education service agency has a contract, unless the person receives compensation or a promotion directly attributable to the contract, or unless the person is employed by the party as a board member, executive officer, or other person working for the party in an area related to the contract;

(4) when the contract is for the sale of goods or services, or for maintenance or repair services, in the regular course of business at a price at or below a price offered to all customers;

(5) when the contract is subject to a public bidding process;

(6) when the contract is with the official depository as set forth in SDCL 6-1-3;

(7) when the person only receives income or compensation, a per diem authorized by law or reimbursement for actual expenses incurred; or

(8) when the contract or multiple contracts with the same party within a twelve-month period with whom the local service agency, school district, cooperative education service unit, or education service agency contracts in an amount less than five thousand dollars.

**10.** The law states that no *School Official* may have an interest in a contract or receive a direct benefit from a contract if that person's school district or educational cooperative is a party to the same (or closely related) contract. What would be some examples of a contract between the local school district and a third party in which a *School Official* (or their spouse) would have an interest in a contract or which would directly benefit the *School Official* such that disclosure would (or would not) be required?

**ANSWER:** School District A must have a contract with third party B and a *School Official* of School District A must have a personal interest in that same or closely related contract *or* receive a direct benefit from that same or closely related contract before disclosure is required. The fact that School District A has a contract with third party B while at the same time a *School Official* of School District A has a contract with third party B does not, by itself, require disclosure.

**Example #1:** School Board member of School District A is a self-employed electrician. School District A contracts with School Board member of School District A to do electrical work at the school. Does the school board member have to disclose the contract?

**Answer:** Yes. Disclosure would be required pursuant to SDCL Ch. 3-23 if the contract value is \$5,000 or more. The self-employed electrician is a school board member in School District A. School District A has a contract with the electrician. The School Board member of School District A has an interest in the contract between School District A and the electrician and receives a benefit from that contract. The requirements for disclosure are met and disclosure is required. Although the contract may be authorized by SDCL 6-1-2, the conflict of interest laws in SDCL Ch. 3-23 require other board members to be aware of the contract and the exception before the school district enters into the contract with the board member.

SDCL 6-1-1 says it is unlawful for any officer of a school district, who has been elected or appointed, to be interested, either by himself or agent, in any contract entered into by the school district, for labor, services, or for the purchase of commodities, materials, supplies, or equipment of any kind. However,

SDCL 6-1-2 authorizes and allows a school board member in eight different situations to have a contract with the school district in which the person serves as a school board member. If a provision in SDCL 6-1-2 allows school board member to have a contract with the school district, the board member still has to disclose the contractual relationship between the school board member and the school district. Several other laws also relate to conflicts of interest within a public school setting.<sup>4</sup>

**Example # 2:** School Board member of School District A owns a landscaping business and has a contract with School District B to do landscaping for School District B. Does School Board member have to disclose his landscaping contract to School District A school board?

**Answer:** No. There is no contract between School District A and School District B in which the school board member from School District A has an interest or derives a direct benefit.

**Example #3:** School Board member of School District A owns a landscaping business and has a contract with School District B to do landscaping for School District B. School District A has a sports co-op agreement with School District B. Does School Board member of School District A have to disclose her/his landscaping contract with School District B to the School District A school board?

**Answer:** No. School Board member of School District A has no personal interest in the sports co-op contract between School District A and School District B. School District A Board member receives no benefit from the sports co-op contract between school districts A and B.

**Example #4:** The superintendent of School District A teaches a class for a university. School District A has a contractual agreement with the same university so student teachers can be in School District A. Does the superintendent have to disclose to the School Board of School District A his teaching contract with the university?

**Answer:** No. The School District A superintendent has no interest in the contract between School District A and the university contract related to student teachers. The superintendent derives no direct benefit from the contract between School District A and the university related to student teachers. \*\*\* However, if the superintendent received a stipend or any other compensation, payment or benefit

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<sup>4</sup> SDCL 6-1-17. Official prohibited from discussing or voting on issue if conflict of interest exists--Legal remedy. No county, municipal, or school official may participate in discussing or vote on any issue in which the official has a conflict of interest. Each official shall decide if any potential conflict of interest requires such official to be disqualified from participating in discussion or voting. However, no such official may participate in discussing or vote on an issue if the following circumstances apply: (1) The official has a direct pecuniary interest in the matter before the governing body; or (2) At least two-thirds of the governing body votes that an official has an identifiable conflict of interest that should prohibit such official from voting on a specific matter. If an official with a direct pecuniary interest participates in discussion or votes on a matter before the governing body, the legal sole remedy is to invalidate that official's vote.

SDCL 13-43-1. Employment of school board member in same district prohibited. No person employed to teach or to draw public money as a teacher may serve as a board member in the same school district.

SD Constitution, Article 8, §17. Interest in sale of school equipment prohibited. No teacher, state, county, township or district school officer shall be interested in the sale, proceeds or profits of any book, apparatus or furniture used or to be used in any school in this state, under such penalties as shall be provided by law.

SDCL 13-20-2.1. Interest of school district officer or employee in sale of school equipment as misdemeanor--Exception. No school district officer or employee may be interested in the sale, proceeds, or profits of any book, apparatus, or furniture used or to be used in any school district of this state in which the officer serves or the employee is employed. A violation of this section is a Class 2 misdemeanor unless the sale is exempt as provided in § 6-1-2 or the purchase is made at public auction.

from the university of \$5,000 or more as a direct result of university student teachers being placed in School District A, then the superintendent would have to disclose his/her direct benefit in the contract between School District A and the university related to the placement of student teachers in School District A, and the superintendent is required to request a waiver and authorization from School District A School Board to receive the compensation from the university.

**Example #5.** A spouse of a *School Official* (or other person with living with the *School Official* and they comingle assets) has a contract (an employment contract, or a contract for goods, services, equipment, materials, etc.) with the school district. Does the *School Official* have to disclose their spouse's contract to the school board?

**Answer:** Yes, if the contract is worth \$5,000 or more. However, based on the nature of the contract, the *School Official* may have only an interest in the contract, which requires disclosure but not governing board approval. The *School Official* could also possibly derive a direct benefit from the contract, in that case both disclosure and governing board approval is required.

Although it is possible (and maybe probable) the local school district board on which the board member serves, or the local school district which employs the business manager or school administrator, knows the school district employs the spouse or hires the spouse as an independent contractor, it should not be presumed. Spouses do not always share the same last name, the new law refers not only to spouses but to people living together and comingling assets, and business names may not clearly identify the business owner/spouse.

**Example #6.** The spouse of a *School Official* in School District A is a special education teacher in School District B and School District A and School District B has a football sports cooperative agreement. Does the *School Official* in School District A have to disclose the spouse's contract with School District B to School District A School Board?

**Answer:** No. The spouse of School District A's *School Official* has no interest in the sports cooperative agreement and receives no benefit from of the sports cooperative agreement between School District A and School District B. School District A's *School Official* would have no personal interest in and derive no direct benefit from the sports cooperative agreement between School District A and School District B.

**Example #7.** The spouse of a *School Official* in School District A is a football coach in School District B and School District A and School District B has a football sports cooperative agreement. Does the *School Official* in School District A have to disclose the spouse's contract with School District B to the School District A school board?

**Answer:** Yes, if the contract is worth \$5,000 or more. However, based on the nature of the contract, the *School Official* may have only an interest in the contract, which requires disclosure but not governing board approval. The *School Official* could also possible derive a direct benefit from the contract, in in that case both disclosure and governing board approval is required.

**11.** Does the conflict of interest law require there be a contract between the local school district and a person (or entity) which directly benefits the spouse of a *School Official* before disclosure is required?

**ANSWER:** Yes, if the value of the contract is \$5,000 or more. If the school board has a contract with a person or entity, **and if** the spouse derives a direct benefit of that same or closely related contract, the *School*

*Official* must disclose that same or closely related contract. The fact that the spouse has any type of contract with a person or entity that also has a contract with the school district does not automatically require disclosure of the spouse's contract. The spouse must derive a direct benefit from the contract of at least \$5,000 between the school district and the third person or entity before disclosure and governing board authorization is required.

**12.** What are the consequences for not complying with the conflict of interest laws.

**ANSWER:** The law states that any person who knowingly violates the conflict of interest law must be removed from office or employment and the person is also guilty of a Class 1 misdemeanor (which is punishable by up to a \$2,000 fine and one year in jail), and the person is also guilty of theft under the criminal statutes with the criminal penalties increased because of the conflict of interest. *However*, the law also says that a *School Official* who has an interest in a contract or derives a direct benefit from a contract and has submitted a good faith disclosure or request for authorization pursuant law may not be convicted of a crime. [HB 1170, Section 16]

The law also states that any person convicted of theft [under § 22-30A-10] for unlawfully obtaining property of any its political subdivisions, shall, in addition to other criminal and civil penalties, be disqualified from holding any public office, elective or appointive. [HB 1170, Section 17]

Additionally, any benefit to a person derived from the person's knowing violation of the conflict of interest disclosure and authorization requirements is subject to "disgorgement" (the act of giving up on demand or by legal compulsion something that was obtained by illegal or unethical acts). [HB 1170, Section 16]

Last, any contract made in violation of §§ 3-23-6 to 3-23-8, inclusive, is *voidable* by the governing body of the local service agency, school district, cooperative education service unit, or education service agency. [HB 1170, Section 16]. When a statute says a contract is *voidable*, it means that the school board may (through formal board action), but is not required to, declare the contract void and unenforceable. If a statute says the contract is *void*, then the school board has no discretion in the matter and the contract entered into by the governing body is void and unenforceable as a matter of law. Should the governing board have to address the issue of a contract being voidable the governing board should consult with its attorney prior to taking any action on the contract.

**13.** Are school districts, local service agencies, cooperative education service units and education service agencies required to have a conflict of interest policy?

**ANSWER:** Yes. Section 15 of HB 1170 states "[e]ach local service agency, school district, cooperative education service unit, or education service agency shall develop a written conflict of interest policy, including any disclosure and authorization form that includes the list of any disclosable interest in contracts or direct benefits covered by this Act." ASBSD is amending its sample Conflict of Interest Policy, AH, and disclosure and authorization forms. The new ASBSD sample policy and forms will be available to ASBSD member schools on-line on or before May 26, 2017 on the ASBSD Policy Services website.

*DISCLAIMER: ASBSD provides legal education and information as a general service to ASBSD members. The information provided does not establish an attorney client relationship, and the information provided should not be interpreted or used as a substitute for a legal opinion from your school attorney. Before making legal decisions, school boards and school officials should consult with their school attorney on how to comply with SDCL Ch. 3-23 as amended by HB 1170.*