August 11, 2005

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Dear Mike,

Below is the summary of research of the Sea Grant Law Center regarding federal representation on the boards of the Regional Associations (RAs). The following information is intended as advisory research only and does not constitute legal representation of Ocean.US or the NFRA by the Sea Grant Law Center. It represents my interpretation of the relevant laws and cases.

18 U.S.C. § 208

The Office of Legal Counsel (OLC) within the Department of Justice ruled in 1996 that 18 U.S.C. § 208 prohibits a federal employee from serving in his/her official capacity as a board member of an outside organization. This is a very broad interpretation of §208, a provision that is not, unfortunately, a fine piece of wordsmithery. Section 208 states

> Except as permitted by subsection (b) hereof, ***whoever***, being an officer or employee of the executive branch of the United States Government, or of any independent agency of the United States, a Federal Reserve bank director, officer, or employee, or an officer or employee of the District of Columbia, including a special Government employee, ***participates personally and substantially as a Government officer or employee***, through decision, approval, disapproval, recommendation, the rendering of advice, investigation, or otherwise, ***in a*** judicial or other proceeding, application, request for a ruling or other determination, contract, claim, controversy, charge, accusation, arrest, or other ***particular matter in which, to his knowledge***, he, his spouse, minor child, general partner, ***organization in which he is serving as officer, director***, trustee, general partner or employee, or any person or organization with whom he is negotiating or has any arrangement concerning prospective employment, ***has a financial interest***.[1]

The OLC eliminates the excess words and highlights the key provisions of §208(a) as follows: "Section 208 prohibits any officer or employee of the executive branch from participating as a government official in any 'particular matter' in which an 'organization in which he is serving as an officer, director, trustee, general partner or employee . . . has a financial interest.'"[2] The key to understanding the OLC rationale is thinking beyond personal financial interest, although the statutes does prohibit federal employees from participating in a matter in which they or a family member has a personal financial interest, to the organization's financial interests. The OLC has determined that "when an employee is acting in his or her official capacity as a director or an officer of an outside entity, the work for that entity necessarily entails official action affecting the entity's financial interests."[3]

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[1] 18 USC § 208(a) (emphasis added).
[2] Memorandum for Howard M. Shapiro, General Counsel, Federal Bureau of Investigation, from Beth Nolan, Deputy Assistant Attorney General, Office of Legal Counsel, Re: Service on the Board of Directors of Non-Federal Entities by Bureau Personnel in Their Official Capacities, at 1 (Nov. 19, 1996).
[3] Memorandum for the General Counsel, Office of Government Ethics, from Beth Nolan, Deputy Assistant Attorney General, Office of Legal Counsel, Re: Application of 18 U.S.C. §208 to Service by Executive Branch Employees on Boards of Standard-Setting Organizations, at 1 (Aug. 24, 1998).

The conflict of interest that the OLC is concerned about is the inherent conflict between a federal employee's loyalty to the federal government and his/her fiduciary duties to the outside organization under state law.[4] Corporate directors have two basic fiduciary duties, the duty of care and the duty of loyalty. The duty of care does not create a conflict of interest as it simply requires directors to inform themselves of all material facts and duly deliberate before taking actions. The duty of loyalty, however, requires that directors act solely in furtherance of the best interests of the corporation. To comply with the duty of loyalty, directors must be in a position to make decisions independently (free from extraneous considerations and influences) and disinterestedly. A director is considered interested when divided loyalties are present.

A federal employee serving on a RA board of directors will have divided loyalties. She owes a duty of loyalty to the agency she works for and she owes a duty of loyalty to the RA to act in its best interest. Sooner or later the employee will be put in a situation that pits these two duties against each other. Before an employee can serve on a board of directors, the agency must "rule out the possibility that there could be some potential for overlap between the work of [the] agency and the interests of the outside organization."[5] The Office of Government Ethics states that the Designated Agency Ethics Official for the particular agency in question is in the best position to "determine whether any particular matter at the [agency] could have a direct and predictable effect on the interests of the [organization]."[6]

This conflict of interest can be overcome "only if such service were expressly authorized by statute, or if the outside organization waived applicable fiduciary obligations."[7] A federal employee may serve if authorized by statute, because the statutory mandate subordinates the director's fiduciary duty owed to the corporation to the duties owed to the government.[8] "Where a government official is authorized by statute to serve on the board of a private group as part of his or her official government duties, in what is essentially an ex officio capacity, the reasonable inference to be drawn is that the official is to serve the interests of the government in the event of any conflict between those interests and the interests of the private organization."[9] Statutory authorization may be inferred "when Congress has specifically provided for participation in outside organizations and such participation, to carry out the statutory purposes, entails service on a board."[10]

Section 208 also allows for waivers when the employee's "interest is not so substantial as to be deemed likely to affect the integrity of the services which the Government may expect from such officer or employee."[11]

Service Barred by §208

In 1994, the OLC determined that §208 barred the appointment of the Deputy Assistant Secretary of the Treasury to the Board of Directors of the College Construction Loan Insurance Association (Connie Lee).[12] At the time, Connie Lee was a private, for-profit corporation with stockholders governed by an

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[4] *Id.*

[5] Letter to the Executive Director of a Federal Agency from Marilyn L. Glynn, General Counsel, Office of Government Ethics (Oct. 25, 2001).

[6] *Id.*

[7] *Id.*

[8] Memorandum for Kenneth R. Schmalzbach, Assistant General Counsel, Department of the Treasury, Re: Applicability of 18 U.S.C. § 208 to the Proposed Appointment of the Deputy Assistant Secretary to the Board of the College Construction Loan Insurance Association (June 22, 1994).

[9] *Id.*, *citing* Memorandum for David H. Martin, Director, Office of Government Ethics, from Samuel A. Alito, Jr., Deputy Assistant Attorney General, Office of Legal Counsel, Re: USIA Director's Service on the Board of the United States Telecommunications Training Institute at 2 (Dec. 3, 1986).

[10] Standard-Setting Organizations Memo, *supra* note 3, at 1.

[11] 18 U.S.C. § 208(b)(1).

[12] Connie Lee Memo, *supra* note 8.

eleven-member Board of Directors. The Secretary of Treasury was authorized to appoint two board members, but did not have direct control over (such as the ability to remove) his appointees once they were appointed. Connie Lee was subject to the corporate law of the District of Columbia and the directors could receive compensation for their service as directors. Since the OLC found "no indication that the fiduciary duty of a Connie Lee director appointed by the Secretary is subordinate to any duty to the government," §208 barred official service on the board.[13]

Service Not Barred by §208

The government ethics provisions do not always prohibit official service on outside boards. At least three times, the OLC has determined that federal employees can serve as board members of outside organizations.

In May 1997, the OLC ruled that §208 did not bar the Chairman of the Federal Reserve Board from serving on the Board of Directors of the Bank for International Settlements (BIS).[14] Formed for the collection and transfer of German reparations, the BIS is the main forum for cooperation and information exchange among central banks. The BIS is a profit-making institution with some private shareholders and reserves two seats on its Board for the central bank of the United States. The OLC determined that the Chairman of the Federal Reserve Board and the President of the Federal Reserve Bank of New York had statutory authority to fill these two seats based on the Federal Reserve Board's broad authority to negotiate with foreign central banks.

> "The Federal Reserve Board [Board of Governors of the Federal Reserve System] shall exercise special supervision over all relationships and transactions of any kind entered into by any Federal reserve bank with any foreign bank or banker, or with any group of foreign banks or bankers, and all such relationships and transactions shall be subject to such regulations, conditions, and limitations as the Board may prescribe."[15]

While the OLC did caution that this language might not ordinarily be enough to overcome the §208 prohibition because it does not refer specifically to directorships or the Board's authority to actually enter into "relationships," the statute should be interpreted broadly because service on the BIS is a means of negotiating with foreign governments through their central banks, an arena in which the President has broad latitude.[16] "The directorships in question, like the United States' membership in international bodies, [are] a mode of conducting our foreign relations."[17] Because of the unique setting of the BIS and the Federal Reserve Board's role, the OLC found that §208 did not bar official service on the BIS Board.

A federal official can also serve as a board member of the D.C. Downtown Business Improvement District Corporation (Downtown BID).[18] A District of Columbia ordinance, the Business Improvement Districts Act of 1996 (BID Act), authorizes the formation of "business improvement district corporations" organized under the D.C. Nonprofit Corporation Act. The Downtown BID is governed by a board of directors which "shall include owners . . . and commercial tenants, and also may include residents, community members, and government officials; provided, that not less than a majority of all Board

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[13] Id., page 2.

[14] Memorandum for the General Counsel, Federal Reserve Board, from Richard L. Shiffrin, Deputy Assistant Attorney General, Office of Legal Counsel, Re: Service by Federal Officials on the Board of Directors of the Bank for International Settlements (May 6, 1997).

[15] 12 U.S.C. § 348a.

[16] BIS Opinion, *supra* note 14, at 2.

[17] *Id.*

[18] Memorandum for the General Counsel, General Services Administration, from Beth Nolan, Deputy Assistant Attorney General, Office of Legal Counsel, Re: Applicability of 18 U.S.C. § 208 to Service by Federal Officials on the District of Columbia Downtown Business Improvement District Corporation Board of Directors (Aug. 7, 1998).

members shall represent owners."[19] Due to the large amount of federal property in the Downtown BID, the Government Services Administration (GSA) desired representation on the board.

Although the BID Act is not a federal statute and it did not provide a release of fiduciary duties on behalf of the corporation, the OLC determined that it "provides the equivalent of a waiver of conflicting fiduciary duty" and therefore service is not barred by §208.[20] The OLC interpreted the D.C. ordinance as authorizing a federal official to serve on the Board in his or her official capacity. While the District of Columbia has no authority to modify the duty of loyalty a federal official owes to the government, it does have "the authority to define and thus modify the obligations of a director to a District of Columbia corporation under District [of] Columbia law." The OLC concluded

> that when the Council authorized federal officials to serve as directors in their official capacities, it must be deemed to have anticipated that, in the event of a conflict between the interests of the BID Corporation and the interests of the United States, those officials would serve the interests of the United States. Because the Council has the authority to define the duty of a director under District of Columbia law, its authorization of official service by the federal government officials is best read as implying that serving the interests of the United States in that situation would not violate the director's obligation to the BID Corporation under District of Columbia law.

Finally, State Department employees can serve on the boards of overseas schools and educational facilities.[21] The Secretary of State may establish and operate overseas schools and educational facilities "in such manner as he deems appropriate and under such regulations as he may prescribe."[22] Under State Department regulations "the principal officer designates an officer to be responsible for coordinating the post's interest in school activities. If possible, the officer should be a member of the board of the local school receiving assistance. A management officer personally responsible for administration of the award should not be a member of the school board."[23] The OLC determined that Congress invested the Secretary of State with broad authority to direct employees to take part in the management of overseas schools and "it would 'frustrate [the] arrangements' enacted by Congress to read §208 as a bar to service on these boards."[24]

<u>Conclusion</u>

As the above research reveals, the interpretation provided to the Atlantic Oceanographic and Meteorological Laboratory by the Ethics Division of the Department of Commerce is not new, but the reiteration of a long-standing position of the federal government. The research, however, also suggests that the prohibition on federal employees serving on outside boards of directors is not absolute. There are a few exceptions.

There are a number of discussions that need to take place between various individuals. First, federal employees interested in serving on RA boards must approach their agencies' ethics attorneys for authorization to participate. While it will be easier for the agencies to issue a blanket statement regarding participation on RA boards, conflict of interest determinations really should be done on an individual

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[19] D.C. CODE ANN. §1-2277(a).
[20] Downtown BID Opinion, *supra* note 18, at 2.
[21] Letter for the Deputy Legal Advisor, Department of State, from Beth Nolan, Deputy Assistant Attorney General, Office of Legal Counsel, Re: Official Service by State Department Employees on the Boards of American-Sponsored Schools Overseas (Sept. 11, 1998).
[22] 22 U.S.C §2701.
[23] 2 Foreign Affairs Manual 613 (2003).
[24] Overseas Schools Memo, *supra* note 21, at 2.

basis. Whether a conflict of interest exists depends on the agency, the employee's job description, the state of incorporation, and several other factors.

The NFRA and representatives of the individuals RAs should be part of these conversations. It is essential that the agency attorneys understand the types of decisions the board members will be involved in and have to vote on. For instance, will the board of directors be responsible for approving budgets or hiring staff? Will they operate by majority vote or consensus? Will they be compensated for their service? Each RA needs to determine the extent of their director's obligations under the RA bylaws and pass that information on to the government attorneys.

The key is to find some provision, in a federal statute, state law, or the corporate bylaws, that subordinates the federal employee's duty of loyalty to the corporation to her duty of loyalty to the government. If such a provision exists, the employee should be able to serve. Some states may allow a waiver of some fiduciary duties, but I am not aware of any state codes that explicitly allow directors to waive their *duty of loyalty* to the corporation.

In Maine, for example, state law states that "a director shall discharge the director's duties: (A) in good faith; (B) with the care an ordinary prudent person in like position would exercise under similar circumstances; and (C) in a manner the director reasonably believes to be in the best interest of the corporation."[25] The Maine Supreme Court has consistently ruled that "corporate fiduciaries in Maine must discharge their duties in good faith with a view toward furthering the interest of the corporation."[26] It does not seem likely that the state would permit a board member to waive her duty of loyalty, but additional research should be done in this area to determine if there are *any* fiduciary duties that can be waived in Maine or other states.

I hope you find the above information useful. I look forward to working with NFRA in the coming weeks to investigate potential solutions to the federal participation issue, such as legislation and alternative governance structures. Do not hesitate to contact me if you have additional questions.

Sincerely,

Stephanie Showalter
Director, National Sea Grant Law Center

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[25] ME. REV. STAT. tit. 13-B, § 717(1).
[26] *Northeast Harbor Golf Club, Inc. v. Harris*, 661 A.2d 1146, 1148 (Me. 1995).