

7. AUDITOR GENERAL'S DISCUSSION PAPER ON OPTIONS FOR THE REFORM OF THE LOCAL AUTHORITIES (MEMBERS INTERESTS) ACT 1968



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PURPOSE OF REPORT

1. This report summarises a discussion paper released in June 2005 by the office of the Auditor General entitled "The Local Authorities (Members Interest) Act 1968: Issues and Options for Reform", attached, and makes a recommendation to the Council.

EXECUTIVE SUMMARY

2. The discussion paper raises issues regarding problems with the Local Authorities (Members Interest) Act 1968 ("the Act"), and suggests possible options for improvements. The Auditor-General wants the discussion paper to be the catalyst for dialogue between relevant stakeholders on the possible reform of the Act.
3. The problems with the Act identified by the Auditor-General include:
 - The obscure language used.
 - The Act applies to several other bodies besides local authorities and they are either not correctly described, or the Act is not applicable to those bodies.
 - Removal from office and criminal prosecution (which go hand in hand) are the only available remedies under the Act, but a criminal conviction is onerous as a consequence for a breach of the Act, particularly when removal from office is, in effect, the real penalty.
 - The Act sets out when a person associated with a company is deemed to share pecuniary interests of that company. The "deeming provisions" are useful in providing certainty for some cases, but they also contain inconsistencies.
 - The scope of the discussing and voting rule in section 6 is uncertain and possibly unacceptably wide, as a result of the recent court decision in *Auditor-General v Christensen* [2004] DCR 524.
 - The contracting rule in section 3 is also problematic, including potential difficulties for candidates for election (or newly elected members) in respect of contracts that were entered into before their election to office.
4. Improvements suggested by the Auditor-General include:
 - The entire Act needs to be rewritten, rather than further amendment legislation.
 - It is desirable to continue to have legislation that fulfils the function of the discussing and voting rule in section 6 of the Act.
 - That the contracting rule in section 3 of the Act not be retained.
 - That a wholly civil penalty for breach of the rules may be more effective than the current criminal sanction.

FINANCIAL AND LEGAL CONSIDERATIONS

5. No relevant considerations at this point. If the discussion paper, or dialogue on the discussion paper, results in a Bill being put before Parliament then there may be legal considerations arising at that time.

STAFF RECOMMENDATIONS

It is recommended that the Council resolve to send a letter to the Secretary for Local Government at the Department of Internal Affairs supporting the Auditor General's opinion that there should be a review of the Act and the rules governing the pecuniary interests of members of local authorities, and encouraging the Secretary to make a review of the Act a priority in 2006.

BACKGROUND/SUMMARY OF THE DISCUSSION PAPER

6. The discussion paper highlights difficulties with the Act and suggests options about how the Act could be improved. The Auditor General notes that it is not his role to say how any revised form of the Act should look and that such policy decisions are for others to make. His hope is that it will encourage relevant government agencies, local authority members, officers and advisers and other interested stake holders to start dialogue on possible reform of the Act.

Current problems with the Act

7. Currently the Act provides for rules about members participating in matters in which they have a pecuniary interest that come before the governing body or a committee of the local authority, and about contracts between members and the local authority.

8. The Auditor-General summarises the two main requirements in the Act as:

“Section 6(1) provides that members must not vote or take part in the discussion of any matter before the local authority in which they have a pecuniary interest (other than one in common with the public), unless any of the statutory exceptions apply. We will refer to this provision as the discussing and voting rule. Breach of section 6(1) constitutes an offence, and a conviction results in vacation of office. The Act requires a member to declare any pecuniary interest at relevant meetings and for the minutes to record that declaration of interest.

Section 3(1) provides that a member of the local authority is disqualified from office who is concerned or interested 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. We will refer to this provision as the contracting rule. If the disqualification applies, it is an offence to continue to act as a member of the local authority.”

The deeming provisions

9. As well as problems with obscure language, which bodies the Act relates to, and criminal penalties under an essentially “civil” Act, the other problem areas are the deeming provisions, the discussing and voting rule, and the contracting rule.

10. The Auditor-General identifies the following difficulties with the company deeming provisions:

“a. A literal reading of the deeming provisions (in relation to the discussing and voting rule, but not in relation to the contracting rule) is likely to catch members who own shares in companies solely as a trustee of a trust (but who are not beneficiaries of that trust). This may be unnecessarily harsh.

b. The deeming provisions do not apply to other bodies such as partnerships. Partnerships are used as the legal structure for many professional businesses (such as law and accounting firms), so it is unclear when a partner in a firm should be deemed to share the pecuniary interests of that firm. Arguably, similar deeming provisions ought to apply.

c. It is not entirely clear whether the deeming provisions are exhaustive in relation to companies - in other words, whether interests that fall short of the statutory threshold are automatically assumed not to give rise to a pecuniary interest in the company’s affairs.

d. The deeming provisions refer to a “member” of a company. This terminology comes from the now-repealed Companies Act 1955, which used that word to mean “shareholder”. Sometimes the term is mistakenly thought to refer to a director. The terminology could usefully be updated.”

11. There are also uncertainties where deemed interests arise through spouses.

The discussing and voting rule

12. The Auditor-General notes that the basic rule is not problematic but there is room for clarification. There are also two different exemption powers in the Act, which can be confusing. These powers could usefully be reviewed and, if both are to be retained, combined.
13. Uncertainty has also been created by a recent Court decision, *Auditor-General v Christensen* [2004] DCR 524. In that case it was alleged that at community and ordinary meetings of the Selwyn District Council the defendant, a member of the council, spoke on a matter in which he had a pecuniary interest, other than an interest in common with the public. The matter on which he spoke was in regard to a proposal that the council set up a priority booking system for the provision of connections to council sewerage systems. The defendant's position in the discussion was that, rather than payment in full in cash to secure priority, developers should be able to enter into a bond to secure payment at a later date. The defendant, by reason of his shareholding and position in a company engaged in subdivision, was deemed to be a subdivider. He was engaged at the relevant time in a subdivision at Lincoln that would require a substantial number of sewerage connections.
14. The Court held that remoteness was a relevant factor. The Court was satisfied there was a pecuniary interest in existence at the time of the various meetings, rather than the possibility of a future pecuniary interest. However, addressing the question of remoteness, the Court considered that at the time of discussion, no one could predict whether or not the proposed policy would be adopted. The Court thought the outcome was too remote to visit serious criminal consequences.
15. Section 6(3)(e) of the Act specifically excludes from the pecuniary interest provision "*the preparation, recommendation, approval or review of a district scheme under the Resource Management Act 1991 or any section of such a scheme*". The Court held that, by reason of s6(3)(e) the impugned discussions were not subject to s6 of the Act. Even if the charge was made out, the Court was satisfied that the defendant did not enter into discussion as a matter of self-interest.
16. The Auditor-General had always taken the view, before this decision, that for the section 6(3)(e) exception to apply, the particular matter before the authority or committee must actually *be* the preparation, recommendation, approval, or review of a district plan (or section of a plan). That is, the exception would not apply if the matter simply *relates to* a district plan or an issue covered by a plan; nor would the exception apply to the preparation, recommendation, approval, or *review of part of or a discrete issue in* a district plan.
17. However, the Court decision appears to apply section 6(3)(e) to matters that "*formed part of the preparation of*" the district plan. The Auditor-General is concerned with this decision because it is likely to be used as a significant precedent decision, but it leaves the scope of section 6(3)(e) unacceptably wide. This is concerning, because:
 - a. *Local authorities typically consider a wide range of matters that may ultimately be included in or managed by a district plan. It now appears that councillors can participate in all such matters even where they have a pecuniary interest. Such a broad interpretation of this exception would erode a great deal of the efficacy of the discussing and voting rule, and so appears inconsistent with the policy of the Act.*
 - b. *It will be more difficult to apply the Act in individual situations, because it will not always be obvious to a councillor - or to those advising him or her - whether a particular matter is covered by the exception."*

The contracting rule

18. The following issues have been identified by the Auditor-General, as problematic with the contracting rule:
- (a) *The \$25,000 annual limit for contracts (above which our approval is required) has not been increased since 1982. Because of inflation over the last 23 years, that limit can now be reached easily, and we receive a large number of applications for approval of a member's interest in contracts. It may be appropriate to review and raise the statutory limit.*
 - (b) *It is not clear whether or not the monetary limit includes GST.*
 - (c) *The contracting rule focuses on the time when payments are made, but these days local authorities more commonly account for contracts on an accrual rather than a cash basis. Therefore, it makes more sense for the rule to focus on the time when the local authority incurs an expense (regardless of when payment is actually made).*
 - (d) *The concept of automatic disqualification, without any formal declaration to that effect, creates uncertainty. A member may be technically disqualified from office without being aware of the fact, or alternatively the member may disagree with our (or someone else's) assertion that they are disqualified. In addition, the concept sits uncomfortably with the power of retrospective approval, which may mean that a member is disqualified for a period but is later deemed not to have been disqualified. Furthermore, it is not entirely clear how long a disqualification lasts.*
 - (e) *The Act establishes different tests for prior and retrospective approval. One test for both types of approval may be simpler to apply.*
 - (f) *The Act requires applications to be made only by the local authority, not by the member personally. Yet it would be unfair if a member was disqualified through an inadvertent (or deliberate) omission by an officer of the authority.*

What reform is required?

19. The Auditor-General considers that it is desirable to continue to have legislation that fulfils the function of the discussing and voting rule, but has doubts as to whether the contracting rule needs to be retained. The Auditor-General also favours retaining the Act as a stand-alone statute, and rewriting the entire Act rather than just amending specific provisions.
20. The suggestion is that the deeming provisions regarding companies and spouses could be improved by:

"Considering whether the deeming provisions should be indicative or exhaustive in relation to the matters they address (and expressly saying so).

Considering whether the company provisions should be expanded to include any directorship (rather than the present requirement to be managing director and a shareholder).

Referring to company ownership with terminology that speaks of having a "beneficial interest" in shares (as opposed to the present reference to being "a member of" a company), so as to exclude persons who own shares purely as a trustee.

Considering whether to establish a threshold for a deemed interest in a partnership (or alternatively, deeming any partner to share the interests of their partnership). Considering whether to deem persons to share the interests of any "business" that they conduct (thus catching sole traders and other legal entities in addition to companies and firms), and/or the interests of any business in which they are employed.

Considering whether to expand the spousal provisions even further, to cover some other relatives."

The discussing and voting rule

21. In relation to the discussing and voting rule the Auditor-General identified the basis for the rule as being a partial codification of the common law (ie judge-made law) about bias in public body decision-making. The Auditor-General is convinced that the purpose and principles underlying the discussing and voting rule remain sound and relevant today, as the nature of local authorities and their decision-making processes have not changed.
22. The Auditor-General considers that in retaining the rule several improvements can be made, and one is that a statutory definition of pecuniary interest may be useful. The Auditor-General suggests the following wording:

“Pecuniary interest” means an interest that a person has in a matter if that matter would, if dealt with in a particular way, give rise to a reasonable likelihood or expectation of appreciable financial gain or loss to that person.

To avoid doubt, a person does not have a pecuniary interest in a matter if the interest is so remote or insignificant that it could not reasonably be regarded as likely to influence the person’s participation in any decision about the matter”

23. The Auditor-General also suggests that the list of exceptions to the discussing and voting rule be reviewed for relevance and obsolescence. The Auditor-General notes that the rule requires the disclosure of a pecuniary interest in a matter at a meeting, and prohibits the member from discussing and voting on the matter, but it does not say what else a member must or must not do. The Auditor-General discusses several possible options for reform, drawing from other jurisdictions, including the possibility of allowing the member to retire to the public gallery and exercise any rights that an ordinary member of the public may have to observe or to seek to address the meeting.

The contracting rule

24. The reasons put forward by the Auditor-General for suggesting there no longer be a contracting rule are set out in Part 4 of the paper, but a number of options are reviewed in Part 5 as to how it could be improved if it was to be retained.
25. The reasons for removing this rule relate to the fact that while it reflects concerns about the potential for a member to profit from their public position, strictly speaking it is not actually part of the law about bias, because it is not connected to participation in decision-making processes. The contracting rule applies regardless of whether or not the member participated in formal decision-making about the contract. It seems to involve a wider question, concerning a person’s suitability to even hold office.
26. The underlying principle seems to be that the mere existence of contracts over a certain value represents either a conflict of interest so pervasive, or an indication of improper behaviour so compelling, that the member should be disqualified from office. But the Auditor-General does not find that principle convincing. Being interested in a valuable contract or series of contracts will certainly create a conflict of interest for the member in certain areas of the local authority’s business, but this need not prevent the person from being a valuable and impartial member in other areas. Automatic disqualification from office may be too harsh a consequence.
27. In addition, instances of poor practice should be exposed by a combination of:
 - new Local Government Act 2002 principles requiring open and prudent decision-making and financial management;
 - accounting and auditing standards;
 - the Official Information Act 1982;
 - the operation of the discussing and voting rule;
 - the organisation’s own internal controls; and
 - scrutiny by the media, the public, politicians, and relevant central government agencies
28. The Auditor-General’s brief review of foreign jurisdictions has also not found any equivalent statutory rules for local authorities abroad.

Has anyone else started dialogue?

29. I have contacted Local Government New Zealand to ask if they or any other body have already initiated discussion with the Department of Internal Affairs in relation to the amendment of this Act. They have informed me that they have been promoting a review of this legislation for some time and have discussed the paper with the department. The department hopes to have a review of this legislation included in its 2005/06 work programme but is waiting for the new Minister to approve the programme. LGNZ have suggested that it would be useful for the Council to write to the department encouraging it to make this a priority.

OPTIONS

30. The issue of reform of the Act is one which impacts directly on elected members and the Council, but more indirectly on the community. The community's interest clearly relates to the purpose of the Act, regarding conflict of interest situations being dealt with appropriately. However, the community also has an interest and benefits from the efficient administration of the Council.
31. Neither of the options below have an immediate effect on the community, but, ultimately, if amendments to the Act are made, which serve to improve the administration of the Act, there will be a benefit for the community. The two options are:
- (a) Do nothing and wait until others start dialogue on reform of the Act. Once others have started the dialogue, the Council could be involved, or it can make submissions on any further discussion paper or legislative Bill that is the result of that dialogue.
 - (b) Be proactive and attempt to start dialogue on reform of the Act, by writing to the Department of Internal Affairs, as suggested in the staff recommendation.

PREFERRED OPTION

32. That the Council be seen as taking a positive/proactive approach and write to the Department of Internal Affairs.