

February 5, 2014

Dominic T. Holzhaus
Principal Deputy City Attorney
City of Long Beach
333 W. Ocean Boulevard, 11th Floor
Long Beach, CA 90802-4664

Re: Your Request for Informal Assistance
Our File No. I-14-218

Dear Mr. Holzhaus:

This letter responds to your request for advice on behalf of Duane Kenagy regarding his duties under the conflict of interest provisions of the Political Reform Act (the "Act").¹ Because you seek general information, we are providing informal assistance. Nothing in this letter should be construed to evaluate any conduct that has already taken place. In addition, this letter is based on the facts presented. The Fair Political Practices Commission (the "Commission") does not act as the finder of fact. (*In re Oglesby* (1975) 1 FPPC Ops. 71.)

Please note that we are only providing advice under the conflict of interest provisions of the Act and not under other general conflict of interest prohibitions such as common law conflict of interest or Section 1090.

QUESTIONS

1. If Moffatt & Nichol (Mr. Kenagy's former employer) pays for Mr. Kenagy's stock in the company in a single lump sum, may he commence work immediately on matters involving the firm?

2. If Moffatt & Nichol pays for Mr. Kenagy's stock with a five-year note payable in monthly installments plus interest at the prime rate, must Mr. Kenagy recuse himself for the duration of the payment stream plus 12 months?

¹ The Political Reform Act is contained in Government Code Sections 81000 through 91014. All statutory references are to the Government Code, unless otherwise indicated. The regulations of the Fair Political Practices Commission are contained in Sections 18110 through 18997 of Title 2 of the California Code of Regulations. All regulatory references are to Title 2, Division 6 of the California Code of Regulations, unless otherwise indicated.

3. If Moffatt & Nichol pays for Mr. Kenagy's stock with a five-year note and a bank purchases the note in return for a discounted payment stream, must Mr. Kenagy recuse himself for the duration of the payment stream from the bank plus 12 months?

4. Does Mr. Kenagy's ownership of the Parsons Corporation stock as part of an ERISA-qualified retirement plan require his recusal from matters involving the firm?

5. If Mr. Kenagy sells his stock in the Parsons Corporation back to the firm and rolls the funds into an individual retirement account, may he begin work immediately on matters involving the firm?

CONCLUSIONS

1. Income from the sale of the Moffatt & Nichol stock for a single lump payment not exceeding the December 31, 2013, valuation is income accrued prior to assuming office. So long as there is no expectation of renewed employment and he has not received other income from the firm (such as dividends on the stock) since assuming office, the income from a former employer exception applies, and Mr. Kenagy does not have a potentially disqualifying interest in the firm.

2. If Moffatt & Nichol pays for Mr. Kenagy's stock with a five-year note, Mr. Kenagy's interest in the note is an investment interest in the firm, and he may not make, participate, or use his position to influence any governmental decision with a reasonably foreseeable material financial effect on the firm. Moreover, Mr. Kenagy may not make, participate, or use his position to influence any governmental decision with a reasonably foreseeable material financial effect on the firm if he has received interest on the note aggregating to \$500 or more in the 12 months prior to the decision.

3. If Mr. Kenagy sells his interest in the note to a bank, Mr. Kenagy will no longer have an investment in Moffatt & Nichol. However, any interest on the note received from Moffatt & Nichol prior to the sale will disqualify Mr. Kenagy from any decision with a reasonably foreseeable material financial effect on the firm if the interest aggregates to \$500 or more in the previous 12 months. Additionally, the full purchase price will be considered income to Mr. Kenagy from the bank, and he may not make, participate in making, or use his position to influence a decision with a reasonably foreseeable material financial effect on the bank if he has received \$500 or more from the bank in the 12 months prior to the decision.

4. Notwithstanding the fact that the stock is part of a retirement plan, Mr. Kenagy's stock in the Parsons Corporations is an investment interest disqualifying him from making, participating in making, or using his position to influence any decision with a reasonably foreseeable material financial effect on the firm so long as he retains ownership of the stock.

5. Income from the sale of the Parsons Corporation stock for an amount not exceeding the December 31, 2014, valuation will be considered income accrued prior to assuming office. So long as there is no expectation of renewed employment and he has not received other income

from the firm (such as dividends on the stock) since assuming office, the income from a former employer exception applies, and Mr. Kenagy does not have a potentially disqualifying interest in the firm.

FACTS

Your office represents the City of Long Beach (the “City”) and its Harbor Department, commonly known as the Port of Long Beach (the “Port”). On behalf of the City and Duane Kenagy, a senior employee of the Port, you are requesting advice regarding Mr. Kenagy’s participation in Port decisions, involving consulting firms that perform contract work for the Port, considering his previous employment with the firms and stock interests in the firms he acquired while an employee of the firms.

The Port is administered by the Board of Harbor Commissioners (the “Board”). The Chief Executive reports directly to the Board. Mr. Kenagy, the Capital Programs Executive, reports directly to the Chief Executive. Mr. Kenagy was appointed in October 2014 and will oversee the Port’s capital improvement program, which is currently budgeted at approximately \$4.5 billion. Mr. Kenagy has 30 years of experience in engineering and management and was previously employed by Moffatt & Nichol engineering consulting firm since 1994, where he rose to Senior Vice President. From 1985 to 1992, Mr. Kenagy was employed by the Parsons Corporation, another engineering consulting firm. Both Moffatt & Nichol and the Parsons Corporation (collectively the “Consulting Firms”) perform substantial contract work for the Port.

Moffatt & Nichol is a privately held corporation. Professional staff of Moffatt & Nichol, who meet certain criteria, are offered shares in the corporation for purchase at full price with company financing. Stock ownership is governed by a stock restriction agreement that addresses ownership rights and limitations. Valuation is determined annually by a formula based on earnings and book value. Upon resignation or retirement, an employee holding shares in Moffatt & Nichol is deemed to have offered the shares for sale to the company as of the final date of employment at the current share value. Upon Mr. Kenagy leaving the firm on November 7, 2014, the Moffatt & Nichol Board of Directors authorized the corporation to acquire Mr. Kenagy’s stock on December 8, 2014. Under the authorization, the purchase price will be based upon the December 31, 2013, valuation of the stock and may be paid in a single lump sum or by a note payable in monthly installments over a five-year period with interest at the prime rate. Mr. Kenagy owns stock worth approximately \$800,000. His interest represents less than 2 percent of the outstanding shares of Moffatt & Nichol.

The Parsons Corporation is also a privately held corporation. During Mr. Kenagy’s employment with the Parsons Corporation, he received Employee Stock Ownership Plan shares as a part of the company’s ERISA-qualified retirement plan. Upon reaching retirement age (65), the stock will be automatically acquired by the corporation at the current price established by independent audit in that year. Mr. Kenagy owns shares currently valued at approximately \$273,000. His interest represents less than 1 percent of the outstanding shares of the Parsons Corporation. Mr. Kenagy may elect to sell the stock back to the firm and roll the amount into an

individual retirement account. Should he choose this option, the purchase price will be based on the valuation of the stock on December 31, 2014, so long as the stock is sold during the year.²

In regard to the work performed by the Consulting Firms, Moffatt & Nichol has a \$25.7 million contract to provide engineering design and construction management services in connection with the Port's \$500 million Middle Harbor Container Terminal Project, and the Parsons Corporation is a party to a \$38.9 million joint venture contract to provide design and environmental documentation services in connection with the Port's \$1.2 billion Gerald Desmond Bridge Replacement Project. The Middle Harbor Container Terminal and the Gerald Desmond Bridge Replacement are the two largest construction projects in the Port at present.

ANALYSIS

Section 87100 prohibits any public official from making, participating in making, or using his or her position to influence a governmental decision in which the official has a financial interest. A public official has a "financial interest" in a governmental decision, within the meaning of the Act, if it is reasonably foreseeable that the decision will have a material financial effect on one or more of the official's interests. (Section 87103; Regulation 18700.)

As the Capital Programs Executive for the Port, Mr. Kenagy is a public official subject to the Act's conflict of interest provisions. However, your question involves only the determination of whether or not Mr. Kenagy has potentially disqualifying interests in either of the Consulting Firms. Interests from which a conflict of interest may arise are defined in Section 87103. Those interests that may be implicated by your account of the facts are the following:

- An interest in a business entity in which the official has a direct or indirect investment of \$2,000 or more (Section 87103(a); Regulation 18703.1(a)); or in which the official is a director, officer, partner, trustee, employee, or holds any position of management (Section 87103(d); Regulation 18703.1(b)).
- An interest in a source of income to the official, including promised income, which aggregates to \$500 or more within 12 months prior to the decision. (Section 87103(c); Regulation 18703.3.)

1. If Moffatt & Nichol pays for Mr. Kenagy's stock in a single lump sum, may he commence work immediately on matters involving Moffatt & Nichol?

In addressing this question, the determinative issue is whether the limited exception for income from a former employer found in Regulation 18703.3(b) applies. Under this exception, an official does not have an interest in a former employer as a source of income if:

² In an email on January 7, 2015, you state that both firms determine the value of their stocks annually, and that Mr. Kenagy has already missed the deadline to sell stocks back to the Parsons Corporation during 2014.

“All income from the employer was received by or accrued to the public official prior to the time he or she became a public official; the income was received in the normal course of the previous employment; and there was no expectation by the public official at the time he or she assumed office of renewed employment with the former employer.”

So long as all income from Moffatt & Nichol is accrued or received prior to Mr. Kenagy assuming office and he does not have an expectation of renewed employment with the firm, the exception for income from a former employee applies. In this case, Mr. Kenagy has or will receive income: (1) as salary from the firm, (2) in the form of stock from the firm, and (3) from the sale of the stock. Generally, all of this income will be considered “received” or “accrued” prior to assuming office. The income from the sale of the stock is “accrued” prior to assuming office even if not yet “received.” (See *Ruiz* Advice Letter, No. A-84-268.) Moreover, Mr. Kenagy does not have an investment interest in the firm once he has sold the firm’s stock. (*Ibid.*) Accordingly, to the extent that there is no expectation of renewed employment and Mr. Kenagy has not received income from the firm (such as dividends on the stock) since assuming office, Mr. Kenagy does not have a potentially disqualifying interest in Moffatt & Nichol if the firm purchases Mr. Kenagy’s stock for a single lump payment based upon the December 31, 2013, valuation of the stock.

2. If Moffatt & Nichol pays for Mr. Kenagy’s stock with a five-year note payable in monthly installments plus interest at the prime rate, must Mr. Kenagy recuse himself for the duration of the payment stream plus 12 months?

Under Section 82034, an “investment” includes any financial interest in a debt instrument. If Moffatt & Nichol purchases the stock with a five-year note, Mr. Kenagy will have an investment interest in Moffatt & Nichol. Moreover, the interest received on the monthly installments is income to Mr. Kenagy accrued and received after assuming office and falls outside of the narrow scope of the exception for income from a former employer. Mr. Kenagy will have a financial interest in Moffatt & Nichol as a source of income if he receives income from the firm aggregating to \$500 or more in the 12 months prior to the decision.

Therefore, if Moffatt & Nichol pays for Mr. Kenagy’s stock with a five-year note, Mr. Kenagy has an investment interest in the firm and may not make, participate, or use his position to influence any governmental decision with a reasonably foreseeable material financial effect on the firm so long as he retains an interest in the note. Moreover, Mr. Kenagy may not make, participate, or use his position to influence any governmental decision with a reasonably foreseeable material financial effect on the firm if he has received interest on the note aggregating to \$500 or more in the 12 months prior to the decision.³

³ Provided that the principal balance on the note reflects the valuation of the stock as determined on December 31, 2013, and Mr. Kenagy does not have an expectation of renewed employment with the firm, income from the sale of the stock does not constitute potentially disqualifying income to Mr. Kenagy under the income from a former employer exception. Mr. Kenagy need not consider the principal balance in determining whether he has received income from the firm aggregating to \$500 or more in the 12 month prior to the decision.

3. If Moffatt & Nichol pays for Mr. Kenagy's stock with a five-year note and a bank purchases the note in return for a discounted payment stream, must Mr. Kenagy recuse himself for the duration of the payment stream from the bank plus 12 months?

Mr. Kenagy will no longer have an investment in Moffatt & Nichol if he sells the note to a bank. However, as discussed above, any interest on the note prior to the sale is income to Mr. Kenagy accrued and received after assuming office to which the income from a former employer exception does not apply. Any interest on the note received by Mr. Kenagy prior to the sale will disqualify him from decisions with a reasonable foreseeable material financial effect on Moffatt & Nichol if the interest on the note aggregates to \$500 or more in the previous 12 months.

Additionally, income from selling the note to a bank is considered separate from income received from his former employer and does not fall under the narrow exception for income from a former employer. While there may be no net gain from selling his investment interest in the note to a bank, the full purchase price will be considered income to Mr. Kenagy because the Commission looks "only at the gross income when analyzing potential economic interests." (*Butt* Advice Letter, No. A-11-115.) Thus, if Mr. Kenagy sells his interest in the note to a bank, he will have an interest in the bank as a source of income if he has received \$500 or more from the bank in the previous 12 months and may not make, participate in making, or use his position to influence a decision with a reasonably foreseeable material financial effect on the bank.

4. Does Mr. Kenagy's ownership of the Parsons Corporation stock as part of an ERISA-qualified retirement plan require his recusal from matters involving the firm?

As defined in Section 82034, an "investment" includes any interest in common or preferred stock. While there is an exception to "investment" for certain ERISA-qualified retirement plans, the exception applies only to certain plans that are "substantially similar to a 'diversified mutual fund registered with the Securities and Exchange Commission under the Investment Company Act of 1940' . . ." (Regulation 18237.) While Mr. Kenagy's retirement plan is qualified, the plan is not similar to a diversified mutual fund, and ownership of the stock will disqualify Mr. Kenagy from making, participating in making, or using his position to influence any decision with a reasonably foreseeable material financial effect on the firm.

5. If Mr. Kenagy sells his stock in the Parsons Corporation back to the firm and rolls the funds into an individual retirement account, may he begin work immediately on matters involving the firm?

By selling the stock back to the Parson Corporation, Mr. Kenagy would no longer have an investment interest in the firm. Provided he has not received other income from the firm (such as dividends) aggregating to \$500 or more since assuming office, and that the Parsons Corporation is purchasing the stock based upon the December 31, 2014, valuation of the stock,

Mr. Kenagy would not have an interest in the Parsons Corporation as a source of income either.⁴ Accordingly, if Mr. Kenagy sells his stock and rolls the funds into an individual retirement plan, Mr. Kenagy would not have a potentially disqualifying interest in the Parsons Corporation.⁵

If you have other questions on this matter, please contact me at (916) 322-5660.

Sincerely,

John Wallace
Assistant General Counsel

By: Brian G. Lau
Senior Counsel, Legal Division

BGL:jgl

⁴ Under the facts provided, we find that the December 31, 2014, valuation of the stock is a reasonable estimation of the value of the stock at the time Mr. Kenagy assumed office. Accordingly, the income received from the sale of the stock as valued on December 31, 2014, was accrued prior to assuming office, and is not considered disqualifying income under the income from a former employer exception. However, as similarly analyzed in Question 1, any dividends received after assuming office would constitute income to Mr. Kenagy from the firm. Moreover, if the sale of the stock is delayed and the purchase price of the stock exceeds the December 31, 2014, valuation, any amount received for the sale of the stock exceeding the December 31, 2014, valuation would also constitute potentially disqualifying income from the firm. To the extent Mr. Kenagy receives income from the firm aggregating to \$500 or more in the 12 months before a decision, Mr. Kenagy may not make, participate in making, or use his position to influence any decision with a reasonably foreseeable material financial effect on the firm.

⁵ Nonetheless, Mr. Kenagy may have potentially disqualifying economic interests arising out of his investment in an individual retirement account unless the investment meets the narrow exception in Regulation 18237 for certain investments “substantially similar to a ‘diversified mutual fund registered with the Securities and Exchange Commission under the Investment Company Act of 1940’ . . .”