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REPORT TO THE HONORABLE
MAYOR AND CITY COUNCILMEMBERS

COUNCIL SHOULD RE-VOTE TO VALIDATE KROLL AGREEMENTS BASED ON APPEARANCE OF IMPROPRIETY OF VOTES BY COUNCIL PRESIDENT SCOTT PETERS

INTRODUCTION

On or about February 14, 2005, the City of San Diego hired Kroll, Inc., a New York-based risk management firm, to conduct an "independent" investigation related to the City's overdue audit for fiscal 2003. Kroll was to reconcile separate investigative reports into alleged illegal acts by City officials involving the City's pension plan and other financial disclosure practices. The engagement was intended to satisfy KPMG, the City's outside auditor, that an appropriate "illegal acts" investigation was conducted by the City in conformance with applicable auditing standards.

Kroll's investigation is not yet complete. The City Council already has authorized $16.2 million for work by Kroll and its law firm, Willkie Farr & Gallagher, and those firms have asked for an estimated $3.2 million to $4 million more to complete their work.

The City Council voted repeatedly in the past year to approve City agreements with Kroll and to dramatically increase Kroll's funding.[1] Council President Scott Peters voted to approve Kroll's funding in each instance. These votes included:

(1) A February 14, 2005 vote for the initial contract, not to exceed $250,000 (See, City Resolution R-300139);

(2) An agreement on or about May 10, 2005 to increase the Kroll funding "for a total not to exceed amount" of $1.75 million (including the $250,000 approved February 14, 2005 and $1.5 million authorized on May 10, 2005) (See, Resolution R-300423);

[1] Some of the votes included companion funding for Willkie, Farr & Gallagher. As the focus of this memorandum is Kroll and conflicts related to Kroll, a complete account of all amounts approved by the Council for the services of Willkie, Farr & Gallagher is not included here.

(3) A June 28, 2005 vote to allocate an additional $200,000 to Kroll as part of more than $700,000 approved for Kroll and Willkie, Farr & Gallagher. (See, Resolutions R-300629 and R-300630);

(4) An August 9, 2005 vote for $1.2 million more for the investigation and to bring the "not to exceed" amount of the Kroll contract to $3.55 million. (*See*, Resolution R-300780); and

(5) A January 17, 2006 vote to provide another $10 million in funding to Kroll and Willkie, Farr & Gallagher. (*See*, Resolution R-301170). At this Council meeting, a Kroll official admitted Kroll had exceeded its allocated amount. As noted above, Kroll has since asked the City Council for an additional infusion of an estimated $3.2 million to $4 million. If these additional funds are authorized, the total authorized amounts could exceed $20 million.

At the time of certain Kroll votes, according to later news reports, the wife of Council President Scott Peters held an estimated $68,000 to $116,000 in stock in Marsh & McLennan, parent company of wholly owned subsidiary Kroll. Marsh & McLennan common stock (ticker symbol MMC) is listed on the New York, Chicago, Pacific and London stock exchanges, according to the Marsh & McLennan website.

Peters' Form 700 Statement of Economic Interest for 2004, filed March 30, 2005 with the City Clerk, states that Peters' spouse acquired Marsh & McLennan stock as "Separate Property" on September 27, 2004 – a little more than four months before the first Council vote on the Kroll contract. Peters valued the stock holdings in 2004 between $10,001 and $100,000. At the time Peters' wife purchased the stock, Marsh & McLennan was the parent company of Kroll.

As of April 3, 2006, Peters' wife reportedly held $78,000 in Marsh & McLennan stock. Peters' 35-page Form 700 Statement of Economic Interest for 2005, filed April 3, 2006, stated the stock was "Spouse's Separate Property" and valued it between "$100,001 and $1 million." Peters' wife may continue to hold the stock.

When news reporters discovered the stock holdings by reviewing Peters' Statement of Economic Interest filed on April 3, 2006, Peters reportedly denied any prior knowledge that Marsh & McLennan owned Kroll. However, a document provided to the City Council in its informational packet at the time it initially voted on Kroll's contract confirms the Council was told Marsh & McLennan was Kroll's parent company. The February 10, 2005 engagement letter signed by Troy Dahlberg, managing director of Kroll, Inc. said, "Kroll is a separately operated wholly owned company of the Marsh & McLennan Companies." The letter is Exhibit B to the resolution adopted by the Council (*See*, Resolution R-300139). Marsh & McLennan announced it would acquire Kroll in May 2004.

According to a news report, Peters' wife reportedly bought more Marsh & McLennan stock on February 14, 2005, the exact same day the Council took action to award Kroll its initial $250,000 contract.

At no time during the Council actions on Kroll did Peters acknowledge his wife's stock holdings in Marsh & McLennan, put a disclaimer on the Council record or recuse himself from any Council action related to Kroll.

DISCUSSION

I. Council President Peters' Failure to Fully Disclose Stock Holdings As of the Dates of the Kroll Votes Has Prevented Our Office From Determining Whether Peters Violated Ethics Rules.

Council President Peters has yet to disclose his wife's stock holdings as of the dates of the Kroll votes. This has made it impossible for the City Attorney to determine whether the value and characterization of that stock (i.e., separate or community property) rose to a level requiring his recusal from the Kroll votes.[2]

This information is required to analyze whether Peters' participation in any or all of the Kroll votes at issue violated the Political Reform Act [PRA] (California Government Code §§ 81000 *et seq*.), enacted by initiative in 1974. As a member of the City Council, Peters qualifies as a "public official" subject to the PRA. Cal. Gov't. Code § 82048, § 82041. Its foundation is the idea that,

> Public officials, whether elected or appointed, should perform their duties in an impartial manner, free from bias caused by their own financial interests or the financial interests of persons who have supported them.

Cal. Gov't. Code § 81001(b). One of the main purposes of the PRA is to ensure impartial decision-making by public officials. *See*, Cal. Gov't. Code §§ 81001, 81002; *Hamilton v. Town of Los Gatos*, 213 Cal. App. 3d 1050 (1989).

Section 87100 prohibits public officials at any level of state or local government from making, participating in making, or in any way attempting to use their official position to influence a governmental decision in which he knows or has reason to know he has a financial interest. Cal. Gov't. Code § 87100. A public official "makes a governmental decision" when the official, acting within the authority of his or her office or position, votes on a matter. Cal. Code Regs. tit. 2, § 18702.1. Consequently, by participating in deliberations and voting on the Kroll agreements, Peters was engaging in conduct regulated by the PRA.

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[2] The City Attorney's Public Integrity Unit, a criminal enforcement division, is investigating Peters' and his wife's stock holdings in relation to the Kroll votes. The Public Integrity Unit has requested relevant documents from Peters and his counsel. Our Civil Advisory Unit, issuing this memorandum, is not involved in the investigation and is awaiting the Unit's report.

However, an analysis of Peters' actions under the PRA requires a review of the extent of Peters' 2005 income and the precise nature of the stock holdings. Absent additional information from Peters, we cannot determine whether he may have violated the PRA by casting Kroll-related votes.

Additionally, an investigation is necessary to determine whether Peters' involvement in any or all of the Council votes violated California Government Code section 1090.

Government Code section 1090 provides in pertinent part, "Members of the Legislature, state, county, district, judicial district and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members." The prohibition applies to virtually all state and local officers, employees and multi-member bodies, whether elected or appointed, at both the state and local level. Under conflict of interest law, a city contract may be voided if a city officer or employee has a financial interest in the contract and the contract was made in the official capacity of such officer, or by a board or body of which he or she was a member. Cal. Gov't. Code §§ 1090, 1092. Here again, we need additional information to determine if a violation occurred.

II. The Votes Have the "Appearance" of Impropriety and the Council Should Take New Action to Validate the Prior Action.

If Council President Peters was aware of his wife's stock holdings, he should not have cast votes to award Kroll millions of dollars in contracts when his wife owned stock in Marsh & McLennan. At best, Peters' votes have the "appearance" of impropriety and taint the Council's action. At worst, the votes constitute a conflict of interest that voids the Kroll agreements.

Absent additional information, this office cannot conclude if wrongdoing occurred. Therefore, the votes remain tainted by the "appearance" of impropriety. For this reason, the Council should take new action – without Peters' participation – to re-vote and validate the prior Kroll actions related to the resolutions cited above.

CONCLUSION

Council President Peters' failure to fully disclose details of his stock holdings in Marsh & McLennan during 2004 and 2005 at the time of the Kroll votes, and the effect of such stock on his total income, has precluded this office from determining whether he has violated the Political Reform Act or Government Code section 1090 by voting on Kroll-related matters.

To avoid the appearance of impropriety now tainting the prior Kroll votes, this office recommends that the Kroll matters be docketed for a new vote to validate the prior actions, without Peters' participation. Additionally, Peters should recuse himself from any future votes

on Kroll matters unless he can provide documentation showing that he and/or his spouse no longer own stock in Kroll parent company Marsh & McLennan.

Respectfully submitted,

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