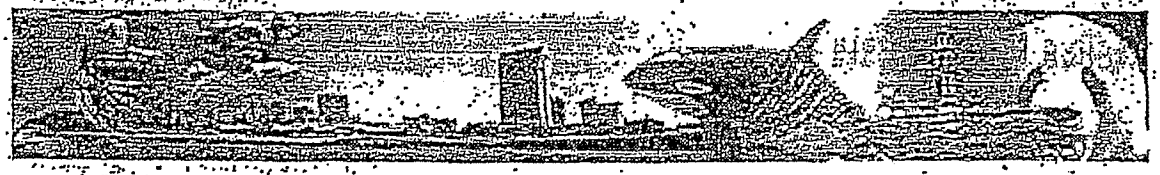
EXHIBIT NO. 1

1. ~~no part to [illegible]~~
2. Require Retirement Officer to come to Rules Committee in March if they don't make Retirement Bd. with Plan to fix
3. What does it take to remove 82% full funding trigger

SAN DIEGO CITY
EMPLOYEES' RETIREMENT SYSTEM
ANNUAL ACTUARIAL VALUATION
June 30, 2001

CITY OF SAN DIEGO



Submitted to

THE RETIREMENT BOARD

San Diego City Employees' Retirement System

San Diego, California

EXHIBIT # 12

San Diego City Employees' Retirement System
Funding Process Indicators - Historic Comparison

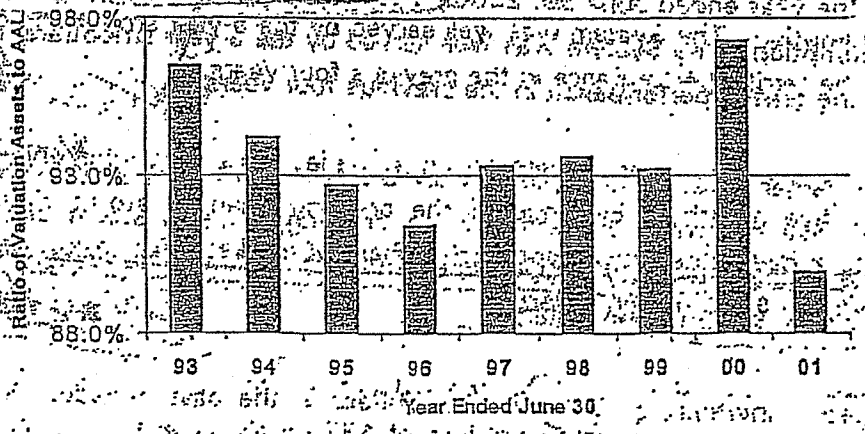
($ in Thousands)

Valuation Date	Valuation Assets	AAL	Funded Ratio	UAAL	Member Payroll	Ratio to Payroll
		Continuation Indicators				
6/30/93	$1,137,019	$1,178,311	96.5%	$41,292	$320,624	12.9%
6/30/94[1]	$1,216,063	$1,290,927	94.2%	$74,864	$338,440	22.1%
6/30/95	$1,316,903	$1,421,150	92.7%	$104,247	$350,584	29.7%
6/30/96[2]	$1,480,772	$1,620,373	91.4%	$139,602	$365,089	38.2%
6/30/97	$1,632,361	$1,748,868	93.3%	$116,507	$382,715	30.4%
6/30/98	$1,852,151	$1,979,668	93.6%	$127,517	$399,035	32.0%
6/30/99	$2,033,153	$2,181,547	93.2%	$148,394	$424,516	35.0%
6/30/00	$2,459,815	$2,343,400	105.0%	($116,414)	$448,502	(26.0)%
6/30/00[3]	$2,459,815	$2,528,774	97.3%	$68,959	$448,502	15.4%
6/30/01	$2,525,645	$2,809,538	89.9%	$283,893	$481,864	58.9%

AAL - Actuarial Accrued Liability

UAAL - Unfunded Actuarial Accrued Liability

Historic Comparison of Funding Value



[1] Reflects revised actuarial and economic assumptions

[2] Reflects Manager's Proposal

[3] Reflects Corbett non-contingent benefit increases

EXHIBIT NO. 2

ATTORNEY TO CLIENT
CORRESPONDENCE

FOR CONFIDENTIAL USE ONLY

CITY OF SAN DIEGO
MEMORANDUM

DATE: June 14, 2002

TO: Honorable Mayor and City Council

FROM: Cathy Lexin, Human Resources Director
Elmer Heap, Head Deputy City Attorney

SUBJECT: Meet and Confer:
Contingent Retirement Benefits – Modified Proposal to San Diego City Employees Retirement System Board of Administration

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BACKGROUND

During the recently concluded meet and confer, the City Council approved a number of retirement benefit enhancements with a contingency feature. The contingency was tied to an affirmative vote by the San Diego City Employees Retirement System (SDCERS) Board oft Administration related to (1) committing $25 million from FY2000 SDCERS investment earnings to pay for retiree health insurance, (2) using an existing SDCERS reserve to pay for negotiated increases in the amount the City "picks up" of employee's retirement contributions, and (3) the City's contribution rates and funding status. We expect that the SDCERS Board will approve the first two items. The third item regarding the City's contribution rates and funding status of the system is the most complex of the issues and is currently under critical review by the SDCERS Board's outside fiduciary counsel and outside actuary.

DISCUSSION

The City Manager made a conceptual presentation before the SDCERS Board at a special meeting held on May 29, 2002. This was the first meeting of the Board after the close of meet and confer. (SDCERS meets regularly once a month on the 3rd Friday.) The Manager indicated that a detailed written proposal would be presented at the next regular meeting of the Board on June 21, 2002 (see attached). The Board's outside fiduciary counsel and actuary were at the May 29, 2002 meeting and have been requested by the Board's Administrator to prepare written opinions from their respective areas of responsibility prior to the June 21, 2002 meeting.

EXHIBIT # 2

Based upon conversations with the Retirement Administrator this week, it appears that the Board's outside fiduciary counsel is "uncomfortable" expressing an opinion that approval of this proposal is within the Board's reasonable discretion as fiduciaries of the system. The current "rate stabilization plan" stipulates that the City's contribution rates, beginning FY97 would increase a fixed 0.50% per year, which is less than the actuarially determined rate necessary to ensure stable funding of the system. The basis for prior fiduciary counsel condoning the original agreement to accept less than full actuarial contributions from the City, was the establishment of a reasonable funding ratio floor (82.3%), and the expectation of progress toward full funding pursuant to this plan. Currently fiduciary counsel is concerned that the City is requesting a further reduction to the funding ratio floor (from 82.3% to 75%) with no balancing aspect to the proposal, no quid pro quo.

RECOMMENDATION

As we discussed in closed session earlier, implementation of the "rate stabilization plan" in the 1997 Manager's Proposal did not have any significant impact on the funding of the retirement system prior to FY01's actuarial valuation wherein the funding ratio dropped from 97.7% to 89.9%. In the past two years, several significant and unpredictable events impacted the funding status of the system. The settlement of the Corbett litigation resulted in approximately $150 million in additional unfunded liability, and the drastic decline in investment earnings to the system (from $415.9 million in FY00 to less than $50 million estimated by year end FY02).

As you know, the Mayor's Blue Ribbon Committee on City Finances also made findings and recommendations regarding the retirement system liabilities and funding status. It is clear that the current arrangement whereby the City's contribution rate increases by a fixed 0.50% per year will not accomplish full funding as contemplated in the plan. A thorough analysis needs to occur and a funding policy developed that is acceptable to the SDCERS Board as Trustees and the City as Plan Sponsor. We had hoped the SDCERS Board would accept our proposal to lower the funding ratio floor to 75% with a commitment from the City to bring forward a long term solution within the next year. It does not appear that the fiduciary counsel will support this request.

Therefore, it is recommended that the City Council authorize the City manager to amend the proposal to be presented on June 21, 2002, by increasing the annual increase in City contribution from 0.50% per year to 1.00% per year beginning in FY05 (an approximate $2.5 million increase). The City Auditor concurs with this recommendation as a necessary step toward the long term solution, and is a means to avoid the potential triggering of the fully actuarial rate in FY04 (a $25 impact).

ALTERNATIVE

If we do not make this offer, it is likely that the SDCERS Board will not approve the proposal based upon a negative report from their fiduciary counsel. It is also a possibility that the funding ratio calculated for year ending FY02 will fall below 82.3% and trigger the full actuarial rate in FY04.

If either the original or this proposal fails, the retirement benefit improvements in the labor agreements with MEA, Local 127 and Local 145 will not occur. MEA has indicated that they will not schedule their ratification vote until this matter is heard by the SDCERS Board, and they anticipate that without the 2.5% at age 55 formula improvement in FY03, the 3-year MOU may fail a ratification vote, in which case we would be bargaining again with MEA next spring.

Attachment: Proposal, dated June 10, 2002, to San Diego City Employees' Retirement System (SDCERS) Board of Administration

A	B	C	D	E	F	G	H
Fiscal Year	Agreed to City Rate	Projected Actuarial City Rate	Actual Actuarial City Rates	Proposed New City Rates	Amended New City Rates	City Rates If 75% Ratio is triggered	Actual Funding Ratio
FY96	7.08%	8.60%	8.60%				91.4%*
FY97	7.33%	10.87%	9.55%				93.3%
FY98	7.83%	12.18%	10.87%				93.6%
FY99	8.33%	12.18%	10.86%				93.2%
FY00	8.83%	12.18%	11.48%				97.3%
FY01	9.33%	12.18%	11.96%				89.9%**
FY02	9.83%	12.18%	12.58%				
FY03	*10.33%*	*12.18%*	*15.59%*				
FY04	10.83%	12.18%	16.65%	11.89%	11.89%	12.84%	
FY05	11.33%	12.18%	16.65%	12.39%	12.89%	13.79%	
FY06	11.83%	12.18%	16.65%	12.89%	13.89%	14.74%	
FY07	12.18%	12.18%-	16.65%	13.39%	14.89%	15.69%	
FY08	13.00%	13.00%	16.65%	13.89%	15.89%	16.64%	
FY09					16.65%		

Column A: Fiscal Year
Column B: City's "Agreed-To" Contribution Rate Based on 1996/97 Manager's Proposal
Column C: Actuarial Rate Projections from FY1996/97 Manager's Proposal
Column D: City Rates based on actuarial valuations for respective fiscal years through FY03 and projected actuarial rates through FY08
Column E: Adding 1.52% to General Member rates (resulting in a blended rate increase of 1.06%) beginning in FY04 to pay the cost of the 2.50% at age 55 formula improvement
Column F: Increasing the +0.50% per year "agreed-to" rate in1996/97 Manager's Proposal to +1.00% per year beginning in FY05
Column G: Increases the City contribution to full actuarial rate over five (5) years if the proposed 75% funding ratio is triggered in FY04
Column H: Funding Ratio of the Retirement Systems (projected assets compared to liabilities) effective fiscal year end (e.g. 89.9% as of 6/30/01)

* The actuary report for 6/30/96 reflected a funding ratio of 92.3% for combined City and Port assets. The 92.3% is the ratio used in the 1996/97 Manager's Proposal. That funding ratio 6/30/96 for only the City's portion of the system assets was 91.4%. A more accurate floor which would trigger the full actuarial rate under the 1996/97 Manager's Proposal.would is 81.4 %. Beginning with the 6/30/99 actuarial valuation, the actuary identified separate City and Port funding ratios, and the ratios in Column H above reflects the City-only funding ratio beginning with the FY00 ratio.

** FY01 *Draft* Actuarial Valuation is docketed for adoption by SDCERS on June 21, 2002

EXHIBIT NO. 3

approved 6-3 at St. by

Meet & Confer 2002

Authorization of Final Economic Bargaining Authority (Action)

Management Team Recommendation:

- Authorize removal of MVLF contingency language
- Authorize the proposed three year agreement as the City's final economic bargaining position
- Condition all retirement enhancements on removal of the "trigger" in the "Managers Proposal regarding CERS funding ratio"
  - Retiree health
  - Increase in Pickups ***until CERS reserve depleted***
  - Increase in General Member Formula

*If CERS funding ratio drops below 82.3% (currently 89.9%) City must pay full actuarial rate, $25m more annually.

17

Meet & Confer 2002

SAFETY MEMBER BENEFITS COMPARISON

	Police/Fire	Lifeguards
Retirement	3% @ 50	3% @ 50
Retirement P/U	7.3%	7.3%
SPSP	N/A	3.05% Mandatory* 3.05% Voluntary*
Uniforms	$700/yr	$965/yr
EMT Pay	5%	5%

*City matches employee's contribution

18

EXHIBIT # 45

EXHIBIT NO. 4

OFFICE COPY

Office of
The City Attorney
City of San Diego
MEMORANDUM

236-6220

DATE: February 21, 2002

TO: Charles G. Abdelnour, City Clerk

FROM: City Attorney

SUBJECT: Closed Session Agenda Items for February 26, 2002

Please place the following matters on the City Council Closed Session docket for Tuesday, February 26, 2002, at 9:00 a.m.

I. Conference with Legal Counsel - existing litigation, pursuant to California Government Code section 54956.9(a):

a. *Clear Channel Outdoor, Inc. and Viacom Outdoor Advertising, Inc. v. City,*
U.S. District 01cv1941

b. *Center for Biological Diversity, et al. v. Berg, et al.,*
U.S. District 98cv2234

c. *Dutcher v. City,*
S.D. Superior GIC 729830

d. *Oakley v. City, et al.,*
S.D. Superior GIC 762537

e. *Equivias v. City,*
S.D. Superior GIC 771572

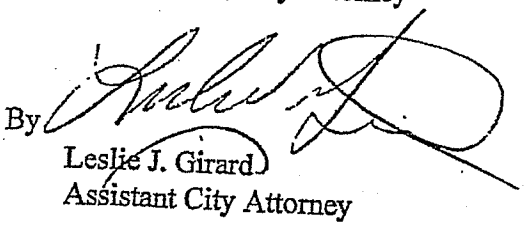
II. Conference with Labor Negotiator, pursuant to Government Code section 54957.6:

Agency negotiators: Michael Uberuaga, Lamont Ewell, Cathy Lexin, Dan Kelley, Stanley Griffith, Mike McGhee

EXHIBIT # 40

Employee organizations: Municipal Employees Association, Local 127 AFSME, AFL-CIO, Local 145 International Association of Firefighters AFL-CIO, San Diego Police Officers Association.

CASEY GWINN, City Attorney

By 
Leslie J. Girard
Assistant City Attorney

LJG:js

EXHIBIT NO. 5

TW Box 5 19/30

From: Terri Webster
To: Lawrence Grissom
Date: Thu, Mar 7, 2002 1:12 PM
Subject: Re: earnings — yuk

Thank you for the info. Larry
1. When will know the impact on the funding ratio for your, I'll call it, Plan A ??

2. When will you know, with the earnings that are projected for 02, what will the funding ratio be at June 30, 2002?

Oh course a rough estimate, qualified, is better than nothing at this point. These answers are needed next week...please...

Thanks much
Terri

>>> Lawrence Grissom 03/06/02 05:32PM >>>
Hi Terri
You should get your Board book tomorrow. To give you a heads up on the earnings report, which I just finished about an hour ago.
Ad Hoc Committee met March 4 — no recommendations. Next meeting March 18.
Preliminary recommendation from staff (lucky me) is that— earnings still look to be in the $50 to $60 million range. That will pay employee and employer reserves at 8%. Liqidate from the general reserve to fund the budget. 13th check reserve will pay about 95 cents on the dollar. Do not credit the insurance reserve, but insurance will be paid next year because there is about 2 years worth of premium built up. Pay nothing else. Lori and I are working on the question of whether we have the authority to go to the contingency reserve or the general reserve for any of the other items. Film at 11.

Rick is working on a couple of what if scenarios relating to funding ratio. Hope to have answers soon. New benefits are a question mark. We are so close to the line on funding ratio, that Rick or I cannot predict until labor relations gives us something specific. If they go the general member increase and increase the offset, my best guess is that with a flat investment enviornment ie no gains, no losses, we will be around 83%.
Gonna get ugly.

Larry

Lawrence B. Grissom
lgrissom@sandiego.gov
(619) 533-4655

CC: Cathy Lexin; Ed Ryan

EXHIBIT # 14

EXHIBIT NO. 6

CITY OF SAN DIEGO
MEMORANDUM

DATE: March 15, 2002

TO: Honorable Mayor and City Council

FROM: Daniel E. Kelley, Labor Relations Manager

SUBJECT: Closed Session Meet and Confer Materials for March 18, 2002

Attached is the Closed Session meet and confer Powerpoint outline for the extended 9 a.m. to 12 p.m. meeting on Monday, March 18, 2002.

Daniel E. Kelley

Attachment

EXHIBIT # 42

Meet & Confer 2002

Retirement System and Meet & Confer

- The System's Actuary performs an annual "valuation which tests certain "assumptions" against actual experience:
  - Investment return (earnings)
  - Employee withdrawals prior to vesting.
  - Mortality rates
  - Disability rates
  - Pay increases
  - Age at retirement
  - Others

Meet & Confer 2002

Retirement System and Meet & Confer

An annual "*actuarial valuation*" measures the funding status of the system (actuarially computed present value of future retirement liabilities")

FY96 = 91.4%
FY97 = 93.3%
FY98 = 93.6%
FY99 = 93.2%
FY00 = 97.3%
FY01 = 89.9%

Meet & Confer 2002

Employer Contribution Rate Stabilization Plan

Period	PUC Rate	Actual Rate	City Paid Rate	Difference %	Difference $	Earnings
FY96	8.60%	8.60%	7.08%	1.52%	$5.33m	$150.4m
FY97	10.87%	9.55%	7.33%	3.79%	$13.88m	$137.4m
FY98	12.18%*Est	10.87%	7.83%	4.35%	$16.67m	$247.4m
FY99	12.18%*Est	10.86%	8.33%	3.85%	$15.40m	$189.1m
FY2000	12.18%*Est	11.48%	8.83%	3.35%	$14.00m	$415.9m
FY2001	12.18%*Est	11.96%	9.33%	2.85%	$12.45m	$168.0m
FY2002	12.18%*Est	12.58%	9.83%	2.35%	$10.72m	$ 52.0m est
FY2003	12.18%*Est	15.59%	10.33%	1.85%	$8.82m	
FY2004	12.18%*Est		10.83%	1.35%	$6.73m	
FY2005	12.18%*Est		11.33%	.85%	$4.43m	
FY2006	12.18%*Est		11.83%	.35%	$1.91m	
FY2007	12.18%*Est		12.18%	-0-	-0-	
FY2008	13.00%*		13.00%	-0-	-0-	
TOTAL					$110.35	

65

Meet & Confer 2002

Retirement System and Meet & Confer

The "Manager's Proposal" effective 1/97:

Earnings Compared with Funding Ratio

FY96	$150.4 m	91.4%
FY97	$137.4 m	93.3%
FY98	$247.4 m	93.6%
FY99	$189.1 m	93.2%
FY00	$415.9 m	97.3%
FY01	$168.0 m	89.9%
FY02 Est.	$50 to $60 m	?

- $105 m reserve would drop to = 85.6%
- Corbett, if amortized = 83.1%
- "Trigger" in Manager's Proposal requiring City to pay full rate = 82.3%
  (a potential $40m annual impact)

66

Meet & Confer 2002

Retirement System and Meet & Confer

- Retirement enhancements have been funded
  - By increasing City and employee contributions, and/or
  - By absorbing as a future liability of the Retirement System
- Given recent actuarial losses of the System, any consideration to absorb costs must carefully evaluate impact on System's funding ration

67

Meet & Confer 2002

Action

Recommendations For Active Employee Plans:

1. Authorize renewals at premiums shown earlier with PacifiCare and Kaiser
2. Authorize modified co-pays by employees that standardize plan designs for PacifiCare (Option 1) and Kaiser (Option 2) HMO plans in line with industry standard:

   $10 office visit co-pays by employees

   $5 generic/$10 brand Rx with formulary

   $50 emergency room co-payment

68

Council
Stevens
Fuyl
Anzuzza
Main
Atkins
Peters
Wear
Mayor
8-0

EXHIBIT NO. 7

Fringe

Wear - Lifeguard

900 AM

Meet & Confer 2002

Management Team Recommendations

Impacts of:

- Motor Vehicle License Fees Re-opener
  - Impact on ability to reach agreement
  - Impact on ability to achieve multi-year agreements
- Parity
  - Relative Values of packages
  - Total package

15

FLEX

Meet & Confer 2002

Authorization of Final Economic Bargaining Authority (Action)

Management Team Recommendation:

- Authorize removal of MVLF contingency language
- Authorize the proposed three year agreement as the City's final economic bargaining position
- Condition all retirement enhancements on removal of the "trigger" in the "Managers Proposal regarding CERS funding ratio*
  - Retiree health
  - Increase in Pickups (Contingent on upon funds being available in resource funds)
  - Increase in General Member Formula

Union + Ret. Bd

Move 2 Mudaffer Mayor Wear

Lifeguards treated as safety -

*If CERS funding ratio drops below 82.3% (currently 89.9%) City must pay full actuarial rate, $25m more annually.

16

Inzunza - too risky!

Wear - Lifeguards 4/15/02

decision continued to 4/16/02

EXHIBIT # 44

EXHIBIT NO. 8

CLOSED SESSION REPORT [X] CITY OF SAN DIEGO [ ] OTHER (SEE BELOW)

TITLE: Labor negotiations - meet and confer
labor negotiations DCA Rivo

DATE OF CLOSED SESSION: 4/29, 2002

NOT A PUBLIC RECORD
until the information in this box is completed, signed by an authorized representative of the City Attorney's Office and stamped in the space below

Date Litigation Concluded: _____, 200__

By: _____

Title: _____

[ ] REAL PROPERTY NEGOTIATIONS G.C. § 54956.8
[ ] Ongoing/Status Report
[ ] Final Approval of Agreement (D)
Substance of Agreement _____
[ ] Final approval dependent on other party

[ ] LITIGATION G.C. § 54956.9
[ ](a) Pending [ ](b)(1) Significant Exposure [ ](b)(2) Authorizing Session [ ](c) Initiating
[ ] Defend Litigation (D)
[ ] Seek Appellate Review (D)
[ ] Amicus Participation
[ ] Settlement Offer To Be Conveyed
[ ] Initiate Litigation or Intervene (D)
[ ] Status Report
[ ] Refrain from Seeking Appellate Review (D)
[ ] Other (see below)
[ ] Acceptance of Signed Settlement Offer (D)
[ ] Contingent Acceptance of Signed Offer
[ ] Non-Disclosure of Litigation Recommended (check if yes): [ ] See Report
[ ] Interfere with service of process [ ] Impair ability to settle

[ ] CLAIMS DISPOSITION G.C. § 54956.95
[ ] Offer Made [ ] Offer Accepted [ ] See Report

[ ] DECISION ON EMPLOYMENT STATUS G.C. § 54957
[ ] Appoint (D) [ ] Employ (D) [ ] Accept Resignation (D) [ ] Discipline (D)
[ ] Dismissal or Nonrenewal (disclose after exhaustion of administrative remedies) [ ] Performance Evaluation
Title: _____
Change in Compensation: _____

[X] LABOR NEGOTIATIONS G.C. § 54957.6
[X] Ongoing/Status Report
[ ] Final Approval of Agreement (D) Other Party to Negotiations _____
Item Approved: _____

[ ] PUBLIC SECURITY THREAT G.C. § 54957

ATTENDEES:
[X] City Mgr [X] Asst City Mgr [ ] Sr Dep City Mgr (Loveland)
[X] City Atty [X] Exec Asst City Atty [ ] Asst City Atty (Girard)
[X] City Auditor
[ ] Other: Jerry Webster, Pat Frazier, Bruce Herring, Steve Miller, Dan Kelly, Rich Snapp, Mike Rivo, Sharon Marshall, Elmer Heap

[ ] VOTE [ ] NO VOTE NECESSARY

Name	Yea	No	Absent
District 1			
District 2			
District 3			
District 4			
District 5			
District 6			
District 7			
District 8			
Mayor			
Voting Tally			

COMMENTS: _____

SSA - Lif Program 9-0
MEA Pohl Admin Leave Program
Top 3
SSA Mgr's Bus. 9-0
127
POA Harbor Unit (4% increase) 9-0
POA Safety Retirement Status 9-0
Local 145 Heavy Equip / USAE 9-0
MEA Dive Team, Arbitrator Team Pay, P.E. Stipend Pay, Lect. Pay, Uniforms - Non Police Collect. Services, Uniform - Park 9-0

APPROVED: Pension
MEA Page 12 = [illegible] 9-0
127 Chauffeur's license
Street Maint. Equipment 9-0
Bldg. [illegible] 9-0
- 2.5 D 55 (D. Frye-appeal)
- Retiree Health Trust Funding Authority (Page 2) 9-0

NOTE: (D) DISCLOSE FOLLOWING CLOSED SESSION

L:\LDEVANBY\CLSDSESS\Meet_ConferSpcl\042902.frm

EXHIBIT # 50

EXHIBIT NO. 9

Meet & Confer 4/30

Presidential leave

A) MEA & BA only -

Mp. recommendation - base retirement on high 1 yr. union salary.

9-0-0

B) Prospective union pres. -

Trail 1 wk.

C) 145 -

Trail 1 wk.

EXHIBIT NO. 10

SED SESSION REPOR [X] CITY OF SAN DIEGO [] OTHER (See below)

NOT A PUBLIC RECORD
until the information in this box is completed, signed by an authorized representative of the City Attorney's Office and stamped in the space below

Date Litigation Concluded: _____, 200____

By: _____

Title: _____

TITLE Labor negotiations - meet and confer
labor negotiations DCA Rivo

DATE OF CLOSED SESSION: 5/6, 2002

[] REAL PROPERTY NEGOTIATIONS G.C. § 54956.8
[] Ongoing/Status Report
[] Final Approval of Agreement (D)
Substance of Agreement: _____
[] Final approval dependent on other party

[] LITIGATION G.C. § 54956.9
[](a) Pending [](b)(1) Significant Exposure [](b)(2) Authorizing Session [](c) Initiating
[] Defend Litigation (D)
[] Seek Appellate Review (D).
[] Amicus Participation
[] Settlement Offer To Be Conveyed
[] Initiate Litigation or Intervene (D)
[] Status Report
[] Refrain from Seeking Appellate Review (D)
[] Other (see below)
[] Acceptance of Signed Settlement Offer (D)
[] Contingent Acceptance of Signed Offer
[] Non-Disclosure of Litigation Recommended (check if yes): [] See Report
[] Interfere with service of process [] Impair ability to settle

[] CLAIMS DISPOSITION G.C. § 54956.95
[] Offer Made [] Offer Accepted [] See Report

[] DECISION ON EMPLOYMENT STATUS G.C. § 54957
[] Appoint (D) [] Employ (D) [] Accept Resignation (D) [] Discipline (D)
[] Dismissal or Nonrenewal (disclose after exhaustion of administrative remedies) [] Performance Evaluation
Title: _____
Change in Compensation: _____

[X] LABOR NEGOTIATIONS G.C. § 54957.6
[X] Ongoing/Status Report
[] Final Approval of Agreement (D) Other Party to Negotiation: _____
Item Approved: _____

[] PUBLIC SECURITY THREAT G.C. § 54957

ATTENDEES:
[X] City Mgr [X] Asst City Mgr [] Sr Dep City Mgr (Loveland)
[X] City Atty [X] Exec Asst City Atty [X] Asst City Atty (Girard)
[X] City Auditor
[X] Other Mike Rivo, Elmer Heap, Sharon Marshall, Cathy Lexin, Bruce Herring

[X] VOTE [] NO VOTE NECESSARY

COMMENTS: _____

Name	Yea	No	Absent
District 1 M	X		
District 2	X		
District 3	X		
District 4	X		
District 5	X		
District 6	X		
District 7 S	X		
District 8	X		
Mayor	X		
Voting Tally	9	0	0

APPROVED: _____

NOTE: (D) DISCLOSE FOLLOWING CLOSED SESSION

EXHIBIT # 57

L:\LDEVANEY\CLSDSESS\Meet_ConferSpcl\050602.frm

EXHIBIT NO. 11

Report on Investigation

The City of San Diego, California's

Disclosures of Obligation to Fund the

San Diego City Employees' Retirement System

and Related Disclosure Practices

1996-2004

with

Recommended Procedures and Changes to the Municipal Code

September 16, 2004

Paul S. Maco
Richard C. Sauer
Vinson & Elkins L.L.P.
Washington, D.C.

purposes that didn't provide the funding of the benefits that the System is inherently responsible for paying.[257]

Mr. Vortmann, by this time a member of the SDCERS Board, expanded on this theme. After noting with approval the Board's efforts to formalize the status of certain contingent benefits, he commented:

> However, the Board must constantly reconcile [this effort] to the Board's primary mission to insure [sic] there are adequate assets to pay off all the future benefits to both current retirees and current employees when they become retired. The Board needs to assure that the Board is getting the plan sponsor to contribute adequate cash to the Plan the Board administers. For several years now, the Board has been approving an actuarial report that has in its wording: the funding objective of the retirement system is to establish and receive contributions expressed as a percent of active member payroll which will remain approximately level from year to year and will not have to be increased for future generations of citizens. The Board adopts this each year but doesn't follow it. Every effort the fund has to pay a contingent benefit creates a bigger departure from achieving that funding objective. He stated he doesn't begrudge anybody any benefits. However, he is very concerned that for various reasons the Board has continued to create a situation where the City is not paying to the trustees of this Board the cost that the City is incurring each year. The City is purposely pushing out onto future taxpayer's payments for services they are incurring today.[258]

On the same day, Michael Uberuaga, who had succeeded Mr. McGrory as City Manager, appeared before the SDCERS Board and stated that the City intended to seek a modification to MP1 lowering the trigger provision from 82.3% to 75%. On June 10, 2002, he submitted a written proposal requesting that modification to MP1, as well as the Board's agreement that, should the funded ratio decline below the new floor, the City would have a five-year period to ramp up to the full PUC rate.[259] His expressed reasons for this request included the terrorist attack of September 11, 2001, the collapse of the dot.com economy, raids by the State of California on San Diego revenues, and the benefit enhancements mandated by the *Corbett* settlement. He stated that the cost of the benefit enhancements coming out of the meet and

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[257] Minutes of SDCERS Special Board Meeting, at 6 (May 29, 2002) (remarks of Mr. Pierce).

[258] *Id.* at 20-21 (remarks of Mr. Vortmann).

[259] Memorandum from Michael T. Uberuaga, City Manager, to San Diego City Employees' Retirement System Board of Administration, Subject: Proposal of the City of San Diego Regarding Employer Contribution Rates, Health Insurance and Reserves, at 2 (June 10, 2002). The exact language of this proposed provision was:

> If the actuarial rate falls below the floor in any year, the City will increase its contribution rate on July 1 of the following year by an amount equal to one-fifth of the amount necessary to reach the full actuarial rate. The City will pay this increased amount for each of the subsequent four years in order to achieve the full actuarial rate over a five year period.

EXHIBIT NO. 12

From: Lawrence Grissom
Sent: Thursday, June 13, 2002 12:51 PM
To: 20_B@Szumalt.CERS
Subject: cover memo

Sal
here's a cover for the manager's proposal revision
Pleawe do a draft.

As a result of this year's meet and confer process, agreement has been reached on certain enhancements to retirement benefits for general member, changes in the amount of employee contributions paid by the City on behalf of employees, and changes to the reimbursement rate for retiree health insurance. All of these changes are contingent upon the Retirement Board's approval of modifications to the 1996 Manager's Proposal.

The proposal seeks to lower the "floor" in the funding ratio which would trigger accelerated employer contribution rates from the current 82.3% to 75.0% and states that the action required if the floor is reached would be for the City to increase the employer contribution rate paid to the acuarially recommended rate over a period of 5 years. It is important to note that the current actuarial valuation is for the period ending June 30, 2001, which recommends the contribution rates for the fiscal year beginning July 1, 2002. This valuation shows a funding ration of 89.9%. Therefore, the proposed revision would have no impact until July 1, 2003 and then only if the funded ratio fall below 82.3% as shown in valuation for the period ending June 30, 2002.

Staff referred the issue to Hasnon, Bridgett, the Systems's fiduciary counsel, and Gabriel, Roeder, Smith, the System's actuary, for thier review, evaluation and report to the Board. Attached are several items for your review. These are:
1. The proposal from the City Manager
2. The review and evaluation from Hanson, bridgett
3. The review and evaluation from Gabriel, Roeder, Smith
4. A chart showing the differences between the original manager's proposal and the proposed revision.

Lawrence B. Grissom
lgrissom@sandiego.gov
(619) 533-4655

LGE00062926

EXHIBIT NO. 13

Report on Investigation

The City of San Diego, California's

Disclosures of Obligation to Fund the

San Diego City Employees' Retirement System

and Related Disclosure Practices

1996-2004

with

Recommended Procedures and Changes to the Municipal Code

September 16, 2004

Paul S. Maco
Richard C. Sauer
Vinson & Elkins L.L.P.
Washington, D.C.

confer process, estimated at 1.52% of payroll, would be incorporated in the City's contribution levels, which would otherwise continue to follow the schedule provided by MP1.

B. SDCERS' fiduciary counsel and actuary recommend against the first iteration of MP2

The SDCERS Board sought advice from its fiduciary counsel and actuary, and it quickly became apparent that neither would approve the proposal without significant modification. Fiduciary counsel Constance Hiatt and Robert Blum of Hanson Bridgett, in a June 12, 2002 draft letter to SDCERS, described the new Manager's proposal as, in essence, a request that the retirement system give up something of value – the protection of the 82.3% floor – in exchange for nothing. Unlike previous fiduciary counsel, they did not consider the contingent benefit enhancements as an adequate *quid pro quo* in determining whether the SDCERS Board had been offered an acceptable bargain on behalf of System membership. Rather, they focused exclusively on the effect the proposal would have on the financial soundness of the System.

They began their draft opinion letter by noting that the City had been contributing to SDCERS at a level below the actuarial rate since July 1, 1997, and that the disparity between the actuarial rate and the paid rate was increasing. For FY 2003, the City's contributions, pursuant to the first Manager's proposal would be 10.44%, a full 5.26% below the actuarial rate of 15.59%. To date, MP1 had cost SDCERS $90 million in foregone City contributions, including interest. Further, they noted that the anticipated funded ratio at June 30, 2002 was approximately 82.3% – the trigger level for MP1.[260] This would represent a decline of approximately 7.6% over the current valuation.

Ms. Hiatt and Mr. Blum interpreted the trigger mechanism, in accordance with its actual wording, to require that the City make a one-time payment to restore the funded level to the specified floor. Offering the example of a decline in the funded ratio to 80.0%, they estimated that this would require a contribution of approximately $75 million above the scheduled amount. Their letter notes that the new Manager's proposal would allow the City to escape its obligation to make such a balloon payment. Counsel viewed this as a sign that MP1 had proven unworkable. At the time MP1 was under consideration, the City had represented that it would address any potential balloon payment situation by increasing its payments to the System. But, in the event, the City had failed to do so, instead citing financial hardship and requesting additional leniency from SDCERS. In counsel's view, this signaled deterioration in San Diego's financial situation that should be of concern to the Board.

[260] The actuarial valuation would not be completed for many months and would then conclude that the funded ratio at June 30, 2002 was 77.3%. Neither this nor the 82.3% projection in counsel's letter included the additional cost of approximately 2.5% of payroll that would result from factoring in the contingent element of the *Corbett* settlement.

More generally, counsel addressed the proposal as a request by a borrower (the City) for a credit accommodation from its creditor (SDCERS), and found little to recommend it from the creditor's standpoint. "Viewing the City as a 'borrower,' as the Board did in 1996, the City is requesting more favorable terms even though its 'debt' is greater than in 1996 and the original deal objective was not reached."[261] Counsel found that the proposal would weaken the protection to the System provided by the trigger mechanism – which the letter notes was of particular significance to the System's actuary in approving MP1 – without providing any mitigating benefits.[262]

The Hanson Bridgett letter rejects the argument that additional benefits could, in and of themselves, constitute an acceptable *quid pro quo* for the additional "flexibility" in scheduled contributions requested by the City. Although "the courts have indicated that the impairment of the vested right to a soundly funded retirement system can be mitigated by providing comparable new benefits," Counsel concluded that this doctrine goes only to the employer's contractual obligations and not the Board's fiduciary duty to act in a "prudent" fashion. Raising obliquely the perverse incentive created by the benefits-for-contribution-relief aspect of MP1, Ms. Hiatt and Mr. Blum pointed out that, if this were a permissible approach:

> each time [an employer] persuaded a Board to reduce contributions, it could avoid challenges by increasing benefits. This would not pass elementary actuarial requirements. Instead, as set out in the Municipal Code, whenever benefits are increased they should be paid for in accordance with the standard actuarial practice, so normal cost is paid currently and past service costs amortized over an appropriate number of years...[263]

In considering what *would* justify the requested rate relief, counsel suggested: "the Board may wish to consider a lower 'trigger' point if there were material increases in the City's scheduled contributions, so the funding level of SDCERS is substantially strengthened on a current basis." Fiduciary counsel also urged that the Board ensure that all benefit increases (past, present and future) be reflected in the City's contribution rate. This was stated to be necessary to bring the City into compliance with Section 24.0801 of the Municipal Code, which required that

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[261] Draft letter from Constance M. Hiatt and Robert Blum, Hanson Bridgett, to Lawrence Grissom, SDCERS, at 7 (June 12, 2002).

[262] Hanson Bridgett appears to have derived little comfort in the trigger mechanism as a safeguard against under-funding. The letter notes that the floor level is most likely to be hit during periods of economic downturn, when the City will be least able to make additional contributions. Its letter also points out that the 75% level proposed by the Manager's Office is substantially below that used by ERISA "to determine when the employer must make additional contributions to certain private sector plans." *Id.*

[263] *Id.* at 15.

it contribute an amount to SDCERS that covered the normal cost of the System, plus the amortization of past service liabilities over no more than 30 years.[264]

The letter concluded that, should the Board approve the proposal in its current form, a court might conclude that: "the decision was not a proper exercise of the Board's fiduciary responsibilities based on the facts before the Board and the actuaries [sic] opinion to the contrary." The daunting list of remedies a court could then impose included:

> ordering the Board to reconsider its decision; ordering members of the Board who were directly involved in the bargaining process to recuse themselves from any reconsidered decision; ordering the permanent removal from the Board of some or all of its members... [and] imposing personal liability on each member of the Board who voted to approve the proposed amendment...[265]

The SDCERS actuary, Mr. Roeder, was, if possible, less favorably disposed toward the initial iteration of the new Manager's proposal than was SDCERS' fiduciary counsel. His primary objection was that the weakening of the trigger provision transgressed the intended limits of "corridor funding." In materials provided to the SDCERS Board, Mr. Roeder pointed out:

- On an EAN basis, SDCERS had one of the lowest funded ratios in California;
- The gap between the actuarial rate and the City contribution rate was increasing;
- The SDCERS funded ratio was at its lowest point since the 1980s; and
- At the next evaluation, it was expected to fall further.

In a slide, colloquially entitled "Which Way Ya Goin'?," Mr. Roeder illustrated the widening gap between SDCERS' assets and liabilities under two diverging arrows labeled "enhanced benefits" and "contribution relief." Among the listed benefits were enhancements to the pension formula stemming from the 2000 and 2002 labor negotiations. Specified items of contribution relief were: the adoption of the PUC funding method; the resetting of the 30-year amortization period in 1991; the lowered contribution rates under MP1; and the phase-in of certain changes in actuarial assumptions.[266] He provided graphs to illustrate the growing

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264 *Id.*

265 *Id.* at 16-17.

266 In an interview with Vinson & Elkins, Mr. Roeder stated that the assumptions to which he referred involved the reduction in City contribution rates reflecting the fact that certain employees on whose behalf contributions were made would not become vested members of the System. The number of such employees had been overestimated in previous years, causing

disparity between the City's contributions and the PUC rate and the yet greater disparity between those contributions and the EAN rate.

Mr. Roeder had also voiced criticism of certain aspects of SDCERS' funding situation in his actuarial valuation for the fiscal year ended June 30, 2001, completed in early February 2002 and available to the public as an attachment to the SDCERS CAFR for that year. He referred in particular to the damage to the soundness of the System that could result from the misuse of the concept of surplus earnings:

> We offer comment related to disposition of Surplus Undistributed Earnings. Suppose that the System earns 0% in the current fiscal year and 16% next year. Our understanding is that a contribution to Surplus Undistributed Earnings will be made for the 16% year even though there will be no net gain from investments over the two-year period. If extra benefits are conferred in the "good" years, then the median, "after the fact" investment return to finance all other benefits should theoretically be correspondingly lower. We will revisit this issue in the experience investigation.

In all previous years after the adoption of MP1, the Gabriel Roeder Smith & Co. annual valuations had concluded that the System was, as a general matter, actuarially sound. In the 2001 valuation, however, this language included an added element of caution:

> Overall, the financial condition of the retirement system continues to be in sound condition in accordance with actuarial principles of level-cost financing. However, we want all parties to be acutely aware that the current practice of paying less than the computed rate of contribution or pickup will help foster an environment of additional declines in the funding ratios in absence of healthy investment returns.[267]

Also opposed to the amendment to MP1, as initially proposed, was San Diego attorney Michael Aguirre, who, in a letter dated June 20, 2002, threatened the Board and its members with litigation should they approve the proposal as presented. Mr. Aguirre objected to the reduction of the trigger level and expressed skepticism that the City would honor even the reduced level should it be breached. He opined that the SDCERS Board should follow the advice of its fiduciary counsel, Hanson Bridgett, and reject the proposal. "This advice is based

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an excessive discount to the City's contribution rate. Rather than incorporate this in a single upward adjustment to the City's rates, the SDCERS Board had agreed that it would be phased in over a five-year period.

[267] 2001 Actuarial Valuation, supra note 221, at cmt. M, at 17.

on the most fundamental law of trusts," he wrote, "a trustee shall not dissipate the *res* of the trust."[268]

C. Further iterations of the second Manager's proposal

Given the opposition of its fiduciary counsel and actuary, the Board communicated to the Manager's Office that it would not consider the proposal as it then stood. Mr. Uberuaga and his staff responded with two significant modifications. Rather than retain the MP1 schedule of .50% annual increases in City contributions, the Manager proposed to double the increase to 1% of applicable payroll. The amended proposal further provided that the agreement would sunset in FY 2009, at which time the City would pay the full PUC rate – however much progress it had or had not made toward that goal through seven years of stepped-up contributions. The City's contributions would thereafter continue to increase by .50% a year until the EAN rate was achieved, as under MP1.[269] The second iteration of the new proposal, however, retained the proposed reduction of the funding floor to 75% of the AAL.[270]

At the June 21, 2002 meeting of the SDCERS Board, its actuary acknowledged the improvements made in the revision to the new Manager's proposal, but again pointed out in detail the deterioration in the System's funded status, which was even more pronounced when measured under the EAN method. He indicated as causes of the funding shortfall changes in System demographics, substantial additional benefits and the five years of contribution relief provided by MP1. Under these circumstances, he remained unconvinced that lowering the funding trigger was an appropriate action.

> With the original Manager's Proposal, Mr. Roeder said he had similar misgiving as he has today. However, he was more comfortable with the [original] proposal because of the 82.4% [sic] floor. With that floor, it seemed to provide the necessary prudent protection to the System. However, he is concerned with the new proposal because of the coupling of benefit increases to funding, along with the significant change from the 82.3% safeguard to 75%.[271]

Mr. Roeder also objected to the involvement of the Board in the benefit-granting process, a criticism that was voiced in the Hanson Bridgett letter of June 12, 2002, and would be repeated

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268 Similarly, *see* Minutes of SDCERS Board Meeting, at 21 (July 11, 2002) (remarks of Mr. Aguirre).

269 Initial ambiguity on this point was addressed by the Manager's Office in: Memorandum from Bruce Herring, Deputy City Manager, to Lawrence Grissom, Retirement Manager, SDCERS, Re: City's Proposal Regarding Contribution Rates and Reserves and Responses to Questions from SDCERS Trustees (July 1, 2002).

270 Memorandum from Michael T. Uberuaga, City Manager, to SDCERS Board of Administration, Re: June 18, 2002 Modification to the Proposal from the City of San Diego Regarding Employee Contribution Rates, Health Insurance and Reserves (June 18, 2002). *See also* Minutes of SDCERS Board Meeting, at 16-17 (June 21, 2002) (remarks of Mr. Herring).

271 Minutes of SDCERS Board Meeting, at 17- 19 (June 21, 2002).

EXHIBIT NO. 14

MISSION STATEMENT

We pledge to continually deliver accurate and timely benefits through prudent administration and safeguarding of the San Diego City Employees' Retirement System, while ensuring the Fund's maximum safety, integrity and growth.

SDCERS RETIREMENT BOARD MINUTES
THURSDAY, JULY 11, 2002

The Retirement Board of Administration held a Special meeting in the System's Boardroom. Location: 401 "B" Street, Suite 400, San Diego, CA 92101. Fred Pierce called the meeting to order at 9:30 a.m.

IN ATTENDANCE:

Trustees: Frederick Pierce, Chair; John Casey, David Crow, Ray Garnica, Cathy Lexin, Mary Vattimo, Tom Rhodes, Ron Saathoff, Diann Shipione, John Torres, Terri Webster, Richard Vortmann, Sharon Wilkinson

Staff: Lawrence Grissom, Lori Chapin, Paul Barnett, Roxanne Parks, Sally Zumalt, Delia Lencioni, Dawne Clark, Jean Struiksma, Merlita Hilario

Public: Robert Blum, Constance Hiatt, Rick Roeder, Bruce Herring, Charles Feland, Michael Aguirre, Ann Smith, Judy Folsom, Judy Italiano, Stan Elmore, Garry Collins, Mary Bush, Bud Simpson, Stan Elmore, Pamela Hightower, Conny Jamison, John Swanson, Nancy Acevedo, Ed Lehman, Jorge Montegue, Pamela Hightower, Judie Italiano, Charles Feland & numerous other City employees.

I. DISPENSE WITH THE READING AND APPROVAL OF THE SPECIAL MAY 29, 2002 EARNINGS MINUTES

MOTION TO DISPENSE WITH THE READING AND APPROVE THE 05/29/02 MINUTES: D. CROW
SECOND: T. RHODES
DISCUSSION:
Ms. Shipione asked that the last paragraph of Page 32 be amended to state that she had asked for clarification about the Board's authority; and, that the second paragraph on Page 33 be deleted.

CALL FOR THE QUESTION ON THE MINUTES AS AMENDED.
BOARD: UNANIMOUS
MOTION TO APPROVE PASSED UNANIMOUSLY.

II. REPORT ON ACTION TAKEN AT THE 8:30 CLOSED SESSION MEETING

Mr. Pierce reported that the Board met in closed session at 8:30 a.m. regarding one matter of pending litigation.

EXHIBIT # 63

SUBSTITUTE MOTION TO RECOMMEND THAT CONTINUED DISCUSSION OCCUR BETWEEN FIDUCIARY COUNSEL, THE BOARD'S ACTUARY AND STAFF TO DEVELOP A NUMBER OF APPROPRIATE ALTERNATIVES REPRESENTING THE YELLOW BARS AND THAT THE CITY BE INCLUDED IN THESE DISCUSSIONS WITH STAFF/CITY TO COME BACK WITH A PROPOSAL REPRESENTING ALTERNATIVES: D. SHIPIONE

DISCUSSION:

Mr. Saathoff said he is not willing to continue this item. He believes the City Manager and employees have concerns that need to be addressed. If granted the opportunity, he will make a substitute motion that should accommodate this while requiring the City to make a decision as to whether it would support such motion. If approved, the motion would also require that this be subject to fiduciary counsel and the actuary's review. Whatever the case may be, he encouraged the Board to move forward.

Ms. Shipione's amended motion died for the lack of a second.

Mr. Casey spoke against the original motion, stating he has been around a long time. In the past, the Board has accommodated the City with its funding woes. The fact the actuary's chart shows a big jump in contributions rates is not realistic and, in his opinion, will not happen. The Board should not subject the City to budget busting contributions when the funding crashes through the floor. Since he doesn't believe this will happen, he doesn't think it is fair to compare the red bar with the City's proposal. He believes the new proposal will assist the System in reaching PUC by 2009 than if the Board maintains the 97 MP. Although it pains him to say this, he previously criticized the City's one-year budgeting cycle. Now the City is before the Board eighteen months early asking for the opportunity to discuss this, which is a big improvement. Therefore, their request should be considered.

SUBSTITUTE MOTION TO MODIFY THE 97 MP AS FOLLOWS: 1) ONCE THE 82.3% TRIGGER IS HIT, TO ALLOW THE CITY'S PAYMENT SCHEDULE TO BE THE DIFFERENCE BETWEEN THE CURRENT RATE AND THE ACTUARIAL PUC RATE, TO BE PHASED IN INCREMENTALLY FROM THAT POINT THROUGH 2009; 2) THAT THIS MODIFICATION BE BASED ON THE CURRENT PROJECTIONS WITH THE CITY'S OFFER TO INCREASE ITS CONTRIBUTION RATES 1.0% PER YEAR TO INSURE THE SYTEM IS AT PUC EFFECTIVE 2009 AS OUTLINED IN THE 97 MP; 3) TO TRANSFER $25 MILLION INTO THE HEALTH CARE TRUST TO PAY RETIREE HEALTH BENEFITS WITHOUT LOWING THE FUNDING FLOOR TO 75%; AND, 4) THAT THIS BE CONTINGENT UPON A SATISFACTORY WRITTEN AGREEMENT BETWEEN THE CITY AND RETIREMENT BOARD:

R. SAATHOFF

SECOND: J. CASEY

DISCUSSION:
Mr. Vortmann asked Mr. Saathoff if he would like to see the 1.0% per year increase spread over time on a prorated basis if the 82.3% trigger is tripped with an additional increment to the higher amount with the new funding proposal to be done currently. He asked if Mr. Saathoff is agreeing to the transfer of medical funds.

Yes, per Mr. Saathoff.

Mr. Pierce clarified that the 1.0% would be paid in FY 04 with the phase in occurring if the 82.3% trigger is his.

Mr. Saathoff said he believes the date is FY 05, not FY 04. Although he doesn't have a crystal ball, he is guessing that the Fund will be below 82.3% by 2005, which is why he is willing to agree to this. His motion is also contingent upon a written, legally binding agreement between the Board and the City as approved by the Board.

Mr. Grissom said if the 82.3% trigger is hit, the 2003 valuation would reflect that which is triggered in 2004.

Mr. Saathoff agreed.

Although this is a great idea, Mr. Garnica said the Board should not rush into action. He believes in process, process, process, which requires further Board analysis.

Mr. Saathoff said his motion is subject to fiduciary counsel and the actuary's review and approval. Requiring codification of the contract language should address all of the Board's concerns. If the Board adopts this today, he believes the City will come to a good faith agreement. It is important that the Board take action so the City and Board can move forward with its long-term objective.

Mr. Blum asked if Mr. Saathoff's motion includes the real PUC rate or the fixed PUC rate.

Mr. Saathoff said it includes the current assumptions where PUC would still move. The City's contributions wouldn't fluctuate should the Board decide to later change its assumptions.

In other words, the amount of contributions could change substantially. He intended for the discussion regarding the City's long-term funding solution to occur over the next six-months with the Board. Unfortunately, the Board can't address all of the concerns that are being raised today. However, approving this today would give the City some comfort with regard to its contributions without subjecting it to future Board actions that could cause the City's contributions to fluctuate wildly.

Mr. Blum said Mr. Roeder had informed the Board that he expects somewhat less than a 100 basis point change from the current experience study, which has not yet been approved. He asked if the non-economic assumptions would be included. These details are very important.

Mr. Roeder said 75 basis points in the non-economic assumption changes...

Mr. Saathoff interrupted, stating he would make this subject to future negotiations. If this passes, the City needs some certainty for budgeting purposes with respect to their contribution rates between now and 2009. The Board's action would be predicated on the experience history.

Mr. Pierce said the substitute motion indicates the $25 million would come from the contingency reserve. He reminded the Board that it previously took action to sunset that reserve on 06/30/02 and to transfer that money into the Employer Contribution Reserve account. Therefore, the $25 million would have to come out of this fund.

As the maker of the motion, Mr. Saathoff said he is comfortable with this.

Mr. Blum said this would probably require a change to the Municipal Code language.

Mr. Saathoff said if the Municipal Code requires a change, the City would make the necessary modifications.

Mr. Herring said the Board's action should include that based on existing actuarial assumptions, the City would work with the City Council to implement this. However, the City will have a real problem if this is built into the bogey that would be ramped up over time.

Mr. Pierce asked about the 76 basis points being discussed.

Mr. Herring said he has no idea what this is and it bothers him.

Mr. Saathoff clarified that his motion is predicated on current actuarial assumptions. Future assumptions would be a factor regarding other things the City and Board have agreed to resolve over the next six-months.

To clarify this, Mr. Blum said the 8% earnings rate is one of the current, critical actuarial assumptions. He assumes that this would not be changed for purposes of this contribution schedule. Secondly, Mr. Roeder has determined the current PUC rate in one of his scenarios by taking the pipeline into account. This means the actuarial valuation of assets is higher than the current actuarial value. Therefore, the value of assets would continue to be reduced in this manner.

Mr. Saathoff said these are current policies and assumptions.

Ms. Webster said she had hoped to speak forty minutes ago, so her comments may seem outdated. There are a number of people who are referring to the graphs provided by GRS. She reminded the Board that red bar should be very close to the blue bar. This means the dollar gap coming into the System won't be as big as what has been presented because the City would be paying the full PUC rate in 2009. Additionally, the Board/City entered into an agreement six years ago, which is not working for the reasons stated today. As such, the City approached the Board to request a modification to the 97 MP to avoid the risk of an immediate balloon payment. This is the result of unprecedented economic conditions and to work out a long-term comprehensive funding plan so the Board can deal with other issues. Whether keeping with the 97 MP or approving the new proposal, the bottom line is how to get the City to the point it would be paying its full actuarial contribution rate. If the Board stays with the 97 MP, it could result in the City paying a balloon payment of up to $26 million in less than twelve months. Having to come up with this type of payment could place public services at risk, force layoffs or force the City to issue pension obligation bonds. The City prefers not issuing debt, as interest would be applied. Having to issue debt would mean more money would be going out the door for unnecessary interest payments. This would impact future citizens and City services. Looking at 82.3% funding versus 75% doesn't indicate that the fund is in critical fiscal conditions on a scale of 100%. The amended proposal wouldn't harm the members. Therefore, she did not feel it would be appropriate to force the City pay a $25 million balloon payment, which could be detrimental to our citizens in the way of City services. There isn't a significant difference between the two proposals to warrant the Board forcing the City to do this, especially when it would achieve the same goal in 2009. The City's credit rating is the highest in California. Therefore, she would be comfortable voting in favor of either motion.

Ms. Lexin asked the Board to consider voting on the original motion first, which gives the City more flexibility and a grace period. She asked if Mr. Saathoff would consider withdrawing his substitute motion.

Regarding Ms. Webster's comments, Mr. Pierce said ramping up the amount the City contributes into the System is the Board's fiduciary duty. Although he could support either motion, he believes Mr. Saathoff's is superior to the original. As such, he would vote in opposition to the original motion.

Mr. Saathoff said he would also be opposed to the original motion based on fiduciary counsel's opinion. Since the original motion probably wouldn't pass he was attempting to craft something that the Board could support that would also provide comfort to the City. Therefore, he will not withdraw his substitute motion.

Ms. Lexin said it should only take a few seconds to vote.

If it was the intent to vote on the original motion, Mr. Garnica stated for the record that the Board should have done so before two Trustees were required to depart.

Ms. Lexin withdrew her request and asked for a call for the question on the substitute motion.

Having been a union member for nine years, Mr. Rhodes said he fully respects and understands what the Board is attempting to do. However, he believes it is very improper for a Trustee to make the City's proposal.

Mr. Garnica asked if the substitute motion would be subject to coming back to the Board with the legal issues to be addressed.

Mr. Pierce replied, "Yes." He recaptured the motion for the record.

Mr. Grissom clarified that if the trigger were hit, payments would be made in equal installments from that point until 2009. His recollection is that this would be recalculated yearly.

Ms. Wilkinson asked about the 1.6% contribution relief.

Mr. Saathoff said this was included in the current proposal and doesn't change.

Mr. Torres asked how this motion would impact the employees regarding their benefit increases.

Once the Board takes action, Mr. Herring said Management would meet with the Mayor and City Council.

Before voting on this, Mr. Torres asked if Mr. Roeder or Mr. Blum had changed their opinions.

Mr. Blum said it is somewhat hard to provide an "on the fly" opinion. However, he is much more comfortable that the Board would not be at a material risk by adopting the substitute motion. Absent having all of the facts and the language in front of him, he's not sure how far he could go with this opinion.

Ms. Hiatt said in reviewing the numbers, a faster repayment schedule is better because the incremental earnings paid to the fund would reduce the Board's risk down the road. She asked when the 1.0% rate increase would become effective. Under the 97 MP, Mr. Pierce said it becomes effective 07/01/04.

CALL FOR THE QUESTION ON THE SUBSTITUTE MOTION TO MODIFY THE 97 MP: 1) TO ALLOW THE CITY'S REPAYMENT SCHEDULE TO BE THE DIFFERENCE BETWEEN THE RATE AT THAT TIME AND THE ACTUARIAL PUC RATE IF THE 82.3% TRIGGER IS HIT; 2) THAT THIS AMOUNT WOULD BE PHASED IN INCREMENTALLY ON AN ANNUAL BASIS BETWEEN THAT POINT AND 2009; 3) THAT THIS BE BASED ON THE CURRENT ACTUARIAL PROJECTIONS WITH THE CITY TO INCREASE ITS PAYMENT 1.0% PER YEAR; 4) THAT THE CITY WOULD REACH THE PUC RATE IN 2009 AS INCLUDED IN THE 97 MP SUNSENT LANGUAGE; AND, 5) TO FUND $25 MILLION FOR PURPOSES OF PAYING RETIREE HEALTH CARE BENEFITS. ADDITIONALLY, THIS MOTION DOES NOT INCLUDE LOWERING THE FUNDING FLOOR FROM 82.3% AND IS CONTINGENT UPON A WRITTEN AGREEMENT BETWEEN THE CITY AND RETIREMENT BOARD.

BOARD: 8 IN FAVOR: CASEY, VATTIMO, PIERCE, SAATHOFF, WILKINSON, TORRES, WEBSTER, LEXIN
2 OPPOSED: RHODES, CROW
1 ABSTAINED: GARNICA

MOTION PASSED 8 TO 3.

(Mr. Vortmann and Ms. Shipione had departed the meeting prior to the vote.)

IV. NEXT MEETING: FRIDAY, JULY 19, 2002 – 12:30 PM
401 "B" STREET, SUITE 400
SAN DIEGO, CA 92101

EXHIBIT NO. 15

closed session 7/11/02

- Conflict of interest - memo re mbrs voting on benefits they could enjoy - DS wants a new opinion
- Diann wants a current opinion
- Ray wants written indemnification for this issue -
Prop 162 nexus - clarification get written confirmation w/ explicit wording

fund any defense joint & several unltd applies in case of breach "agreement"

Diann - "condit. n conting upon..." still troubling

DV - approval of the agreement

SDC077008

EXHIBIT NO. 16

From: Rblum
Sent: Saturday, September 14, 2002 10:09 PM
To: LChapin; LGrissom; PBarnett
Cc: chiatt
Subject: pardon me

for being a bit suspicious. but we have not heard from the city re the draft agreement on contributions. it was sent to them on august 26 about 3 weeks ago. (i assume that you still have not heard from the city. right?)

here's my guess there is a good chance that at the 9/20 board meeting they will complain about the agreement ("where did that come from"; "who agreed to that" etc). and if they cannot get rid of the stuff that they dont like, then they will suggest that the city and sdcers powwow to reach agreement on a long term funding program, "just like they suggested before". they dont need agreement now (they never did). and they probably figure that they might do better than what the board gave em in july and worse come to worse they will do what's in the agreement.

comments?

(meanwhile, i am working on an opinion letter. it wont be done for circulation by the board meeting. it is highly dependant on what rick will say in writing and i am trying to find words that will both give him comfort and give the board what it needs. also, to finish it, i will need the minutes of the 7/11 meeting. relatively soon, though, i hope to have a first draft that i can send to you for review.)

also, by the way, if we do get to talk w/ the city re the agreement i have a couple of changes i would like to put in based on the text that i have of ron's motion. i have read it several times and think that there is more there than i found the first time. let me know if you are interested in what i found.

bob

EXHIBIT NO. 17

Exempting an Assistant to the Director Position from the Classified Service in the Governmental Relations Department.

FILE LOCATION: MEET

COUNCIL ACTION: (Tape location: B214-435.)

CONSENT MOTION BY PETERS TO DISPENSE WITH THE READING AND ADOPT THE ORDINANCE. Second by Wear. Passed by the following vote: Peters-yea, Wear-yea, Atkins-yea, Stevens-yea, Maienschein-yea, Frye-yea, Madaffer-yea, Inzunza-yea, Mayor Murphy-yea.

* ITEM-53: Approval of Ordinance amending the San Diego Municipal Code related to FY 2003 Negotiated Retirement Benefit Enhancements.

CITY MANAGER'S RECOMMENDATION:

Introduce the following ordinance:

(O-2003-67) INTRODUCED, TO BE ADOPTED ON MONDAY, NOVEMBER 11, 2002

Introduction of an Ordinance amending Chapter II, Article 4 of the San Diego Municipal Code by amending Division 2 by amending Section 24.0201; by amending Division 3 by amending Section 24.0301; by amending Division 4 by amending Section 24.0402; by amending Division 5 by amending Section 24.0501; by amending Division 8 by amending Section 24.0801, and by Renumbering Section 24.0803 as Section 24.0802; by amending Division 12 by amending Sections 24.1201, 24.1202, 24.1203 and 24.1204; by amending Division 15 by amending Section 24.1507; all relating to the San Diego City Employees' Retirement System.

CITY MANAGER SUPPORTING INFORMATION:

Pursuant to the recently negotiated Memoranda of Understanding and associated agreements with the Fire Fighters Local 145, Municipal Employees Association (MEA), AFSCME Local 127 and the Police Officers Association (POA) the City agreed to implement a number of revisions to Retirement Benefits as defined in the San Diego Municipal Code. Those benefit enhancements and associated San Diego Municipal Code amendments are summarized below:

Presidential Leave - Amends Sections 24.0201 and 24.0301 to provide that a member serving as the duly elected president of a recognized employee labor organization may continue participating in the Retirement System consistent with the governing Memorandum of Understanding (MOU) between the City and his/her employee organization.

Retirement Benefit Factor increase - Amends Section 24.0402 to reflect the new retirement factor (2.5% at 55) available to General Members, as well as the 90% cap on benefits and exceptions to the cap that accompany the new retirement factors.

Stress Disability Benefit Extension - Amends Section 24.0501 to extend the benefit for Members who suffer mental disabilities due to a violent attack in the workplace, from July 1, 2002 to July 1, 2005.

CERS Contribution Agreement - Amends Section 24.0801 to state that the City's contributions to the Retirement System will be based on the terms of a Memorandum of Understanding between the City and the San Diego City Employees Retirement System (SDCERS).

Retiree Health Benefits - Amends Section 24.1202 to reflect the agreed upon reimbursement levels for Health Eligible Retirees.

Employer Offsets - Amends Section 24.1507 to allow payment of the negotiated offsets to employee contributions from the Employee Contribution Reserve; also amends Section 24.1507 to describe more clearly the terms of the Employee Contribution Rate Reserve.

Once approved by City Council, these benefits will be submitted to members of the City Employees' Retirement System (CERS), and will be enacted upon an affirmative vote of the members. This election is tentatively slated for the last week of November, 2002.

FISCAL IMPACT:

Cost of $4.79M for 2.5% at 55 benefit enhancement ($2.26M General Fund; $2.53M Non-General Fund). Costs of $11.34M for Retiree Health Benefits (from CERS 401 (h) & 115 Health Trust Reserves); and $3.24M for Employee Offsets (from CERS Employee Contribution Rate Reserve) were approved by Council July 30, 2002.

Lexin/Kelly

FILE LOCATION: NONE

COUNCIL ACTION: (Tape location: B214-435.)

CONSENT MOTION BY PETERS TO INTRODUCE THE ORDINANCE. Second by Wear. Passed by the following vote: Peters-yea, Wear-yea, Atkins-yea, Stevens-yea, Maienschein-yea, Frye-yea, Madaffer-yea, Inzunza-yea, Mayor Murphy-yea.

ITEM-100: Agreement with Metcalf & Eddy to Provide Vulnerability Assessment Services.

CITY MANAGER'S RECOMMENDATION:

Adopt the following resolution:

(R-2003-522) ADOPTED AS RESOLUTION R-297199

Authorizing the City Manager to execute an agreement with Metcalf and Eddy, Inc. to provide professional consultant services for a Water Security Vulnerability Assessment;

Authorizing the City Auditor and Comptroller to transfer an amount of reimbursable funds, not to exceed $115,000 from the U.S. Environmental Protection Agency grant funding to Water Operating Fund 41500;

Authorizing the expenditure of an amount not to exceed $115,000 from Water Operating Fund 41500, provided that the City Auditor and Comptroller first furnishes one or more certificates demonstrating that the funds necessary for expenditure are, or will be, on deposit in the City Treasury.

CITY MANAGER SUPPORTING INFORMATION:

In order to improve the safety and security of the Nation's water supply, the United States Environmental Protection Agency has appropriated funds to reduce the vulnerability of water utilities to terrorist attacks and to enhance their ability to respond to emergency situations. The Environmental Protection Agency (EPA) has awarded the City of San Diego $115,000. On October 7, 2002, City Council authorized the City Manager to accept the EPA award to complete a vulnerability assessment by January 31, 2003.

EXHIBIT NO. 18

From: Rblum
Sent: Wednesday, October 23, 2002 9:38 PM
To: LChapin; LGrissom; PBarnett
Cc: chiatt
Subject: rivo's email

larry, paul and lori

i have sent to you mike rivo's email w/ my reply on the city's newest desire drop dead date of dec 1 for the city to be told the funding ratio if the trigger is to be pulled for the next fy.

i would appreciate it if you would talk w/ fred about this. from your view, would the concept be ok as long as we can build in protections so, e.g., the city's board rep does not delay the notice to the city? also, i am concerned about the fact that this would put the city's priorities first among all other (unknowable at this time) priorities of the board. that is a fiduciary problem. if you tell me that the dec 1 date can be met in any event if extra $ are paid for staff, overtime, temps, etc for both sdcers and the actuary, that is ok but only if the city pays the extra and the extra is determined at sdcers discretion. plse let me know, however, if it is not realistic that dec 1 could always be met in this way.

finally, you will appreciate that when rivo raised this issue, it seemed to me that all restraints had been eliminated on raising new issues. so i felt it quite appropriate to ask him if the city would pay at least 1/2 of our and rick's costs incurred re the new manager's proposal because that is the standard for transactions. but supposing that you just might disfavor me doing that, i restrained myself.

please, please, oh please unleash me in the next go round w/ rivo. i want him to know that if the city continues to raise the ante, we will do the same.

bob

EXHIBIT NO. 19

From: Lawrence Grissom
Sent: Thursday, October 24, 2002 8:57 AM
To: Rblum; LChapin; PBarnett
Cc: chiatt
Subject: Re: rivo's email

Bob
Just saw this as I was off playing hookey yesterday. I haven't talked to anyone yet, but my first reaction is %^%^$&*^) &*_ to put it mildly. It may seem like a minor issue on the surface, but it is to me yet another example of what is becoming a significant power struggle. The problem with putting something like this in an agreement is that if one or more of the many variables affecting the valuation including Board politics causes a delay, we are in violation of the agreement.....and then what happens????

I will calm down. Fred is out of town and unreachable until after 10/29. This may cause the issue to be delayed until after the November Board meeting.

Larry

>>> "Robert Blum" <Rblum@hansonbridgett.com> 10/23/02 10:38PM >>>
larry, paul and lori

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doing that, i restrained myself.

please, please, oh please unleash me in the next go round w/ rivo. i want him to know that if the city continues to raise the ante, we will do the same.

bob

EXHIBIT NO. 20

From: RICKRO
Sent: Tuesday, October 29, 2002 1:02 PM
To: Rblum
Cc: LChapin; LGrissom; PBarnett
Subject: RE: your letter for sdcers

Bob, I took a look at the version marked 9/16 Item j: "then the transition period is reasonable" hmmmmm, thinking about this, I do not want to have anybody think that we advocate a method, which, in total, would have over a decade of subsidized rates. An easy point to overlook in a written treatise: we already think they have been "in transition" since the original Mgr's proposal in 1996, Rick

Thursday is best as I still have my significant other and a baby still at the hospital.

Original Message
From: Robert Blum [mailto:Rblum@hansonbridgett.com]
Sent: Tuesday, October 29, 2002 1:30 PM
To: 'rickro@grsnet.com'
Cc: 'lgrissom@sandiego.gov'; 'pbarnett@sandiego.gov'; 'lchapin@sandiego.gov'; Connie M. Hiatt
Subject: your letter for sdcers

rick
we are finished negotiating w/ the city re the agreement. a copy of the version that will go to the board is attached. (the examples were worked out w/ larry.) remember the letter that we need from you? we now need to have it signed. a copy is attached. perhaps we should talk for 5 mins before you do it in final.
what's a good time to talk tomorrow or thursday?
bob

<<91702 drft from rick.doc>> <<101602 revised draft clean.doc>>

EXHIBIT NO. 21

From: Rblum
Sent: Tuesday, October 29, 2002 2:11 PM
To: RICKRO
Cc: chiatt; LChapin; LGrissom; PBarnett
Subject: RE: your letter for sdcers

rick
you had signed off on this exact language before. so lots of people would be very unhappy if you are unwilling to sign off on it now. we can talk on thursday. what time?
bob

Original Message
From: Roeder, Rick [mailto:RICKRO@grsnet.com]
Sent: Tuesday, October 29, 2002 2:11 PM
To: 'Rblum@hansonbridgett.com'
Cc: 'CHiatt@hansonbridgett.com'
Subject: FW: your letter for sdcers

Original Message
From: Roeder, Rick
Sent: Tuesday, October 29, 2002 2:02 PM
To: 'Robert Blum'
Cc: 'lgrissom@sandiego.gov'; 'pbarnett@sandiego.gov'; 'lchapin@sandiego.gov'
Subject: RE: your letter for sdcers

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6/14/2004

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EXHIBIT NO. 22

From: Lawrence Grissom
Sent: Wednesday, October 30, 2002 2:06 PM
To: Rblum
Subject: Re: FW: your letter for sdcers

good

>>> "Robert Blum" <Rblum@hansonbridgett.com> 10/30/02 02:32PM >>>
fyi rick will sign. bob

Original Message
From: Roeder, Rick [mailto:RICKRO@grsnet.com]
Sent: Wednesday, October 30, 2002 11:16 AM
To: 'Robert Blum'
Subject: RE: your letter for sdcers

I can live with the language just not optimum. No huge deal at my end

Original Message
From: Robert Blum [mailto:Rblum@hansonbridgett.com]
Sent: Tuesday, October 29, 2002 3:11 PM
To: 'Roeder, Rick'
Cc: 'lgrissom@sandiego.gov'; 'pbarnett@sandiego.gov';
'lchapin@sandiego.gov'; Connie M. Hiatt
Subject: RE: your letter for sdcers

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Sent: Tuesday, October 29, 2002 2:11 PM
To: 'Rblum@hansonbridgett.com'
Cc: 'CHiatt@hansonbridgett.com'
Subject: FW: your letter for sdcers

Original Message
From: Roeder, Rick
Sent: Tuesday, October 29, 2002 2:02 PM
To: 'Robert Blum'
Cc: 'lgrissom@sandiego.gov'; 'pbarnett@sandiego.gov';
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EXHIBIT NO. 23

GABRIEL, ROEDER, SMITH & COMPANY
Consultants & Actuaries

9171 Towne Centre Drive • Suite 440 • San Diego, California 92122 • 858-535-1300 • FAX 858-535-1415

November 7, 2002 (revised)

Board of Retirement
Mr. Larry Grissom
Retirement Administrator
San Diego City Employees' Retirement System
401 B Street, Suite 400
San Diego, CA 92101-4227

Re: Agreement Regarding Employer Contributions Between the City and SDCERS

Dear Members of the Board and Larry:

We are making the following statements in regard to the amendment to the Manager's Proposal.

a) The Agreement provides for better funding of SDCERS than does the existing Manager's Proposal, if the 82.3% funding ratio trigger point is not hit.

b) If the 82.3% funding ratio trigger point is hit, then under two of the three interpretations of the current Manager's Proposal higher contributions would be received from the City.

c) It is likely that the 82.3% trigger point will be hit by June 30, 2003, because of the way that SDCERS' assets are valued for the actuarial valuation.

d) The higher the City's contributions levels, the better for the funding status of SDCERS.

e) The current drop in the market asset values has contributed substantially to the drop in SDCERS' funding ratio. This drop cannot be made up in full in any short period by an actuarially determined increase in the City's contribution rates, but steady contribution increases would be best.

f) The sooner that the City's contribution rate is at the full PUC rate the better. The sooner that the City's contributions rate is at the full EAN rate the better.

g) From a pure actuarial viewpoint, it would be best to hold the City to the existing Manager's Proposal and the 82.3% trigger (particularly if one of the two "high contribution rate" interpretations of the effects of hitting that trigger were to prevail).

h) From a pure actuarial viewpoint, we would prefer it if the Board did not provide a transition period to the City to reach the full PUC rate and then move to the full EAN rate.

i) The Board must exercise its judgment in deciding whether a transition period is needed to ramp up contributions to the PUC and/or s EAN rates.

j) If the Board decides that a transition period is needed, then the transition period chosen is reasonable as the City will commit to contribute an additional amount each year starting in July 2004; if the 82.3% accelerated funding trigger is hit the ramp up to full PUC rates will be accelerated; the City will contribute the full PUC rate starting in July 2008; the entire agreement will sunset on June 30, 2010; and the City and Board agree to move to the EAN rate rapidly after that date.

Very truly yours,

Rick Roeder

Rick A. Roeder, EA, FSA, MAAA

CC: Connie Hiatt, Esq.
Robert Blum, Esq.

EXHIBIT NO. 24

THE CITY OF SAN DIEGO, CALIFORNIA
MINUTES FOR REGULAR COUNCIL MEETING
OF
MONDAY, NOVEMBER 18, 2002
AT 2:00 P.M.
IN THE COUNCIL CHAMBERS - 12TH FLOOR

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CHRONOLOGY OF THE MEETING:

The meeting was called to order by Mayor Murphy at 2:04 p.m. The meeting was recessed by Mayor Murphy at 3:04 p.m. for the purpose of a break. Mayor Murphy reconvened the meeting at 3:11 p.m. with all Council Members present. The meeting was recessed by Mayor Murphy at 4:46 p.m. for the purpose of a break. Mayor Murphy reconvened the meeting at 4:53 p.m. with all Council Members present. Mayor Murphy adjourned the meeting at 6:06 p.m. into Closed Session at 9:00 a.m. on Tuesday, November 19, 2002, in the twelfth floor conference room to discuss existing and anticipated litigation.

ATTENDANCE DURING THE MEETING:

(M) Mayor Murphy-present

(1) Council Member Peters-not present

(2) Council Member Wear-present

(3) Council Member Atkins-present

(4) Council Member Stevens-present

(5) Council Member Maienschein-present

(6) Council Member Frye-present

(7) Council Member Madaffer-present

(8) Council Member Inzunza-present

Clerk-Abdelnour (pr)

FILE LOCATION: MINUTES

ITEM-1: ROLL CALL

Clerk Abdelnour called the roll:

(M) Mayor Murphy-present
(1) Council Member Peters-present
(2) Council Member Wear-present
(3) Council Member Atkins-present
(4) Council Member Stevens-present
(5) Council Member Maienschein-present
(6) Council Member Frye-present
(7) Council Member Madaffer-present
(8) Council Member Inzunza-present

ITEM-10: INVOCATION

Invocation was given by Reverend Louis G. Wargo of the Kensington Community Church.

FILE LOCATION: MINUTES

ITEM-20: PLEDGE OF ALLEGIANCE

The Pledge of Allegiance was led Assistant City Attorney Leslie Devaney.

FILE LOCATION: MINUTES

ITEM-30: Mr. Abdur-Rahim Hameed Day.

DEPUTY MAYOR STEVENS' RECOMMENDATION:

Adopt the following resolution:

(R-2003-582) ADOPTED AS RESOLUTION R-297300

Commending Mr. Abdur-Rahim Hameed for his contributions and dedication to the City of San Diego;

Proclaiming November 18, 2002 to be "Mr. Abdur-Rahim Hameed Day" in San Diego.

FILE LOCATION: AGENDA

COUNCIL ACTION: (Time duration: 2:09 p.m. - 2:14 p.m.)

MOTION BY STEVENS TO ADOPT. Second by Atkins. Passed by the following vote: Peters-yea, Wear-yea, Atkins-yea, Stevens-yea, Maienschein-yea, Frye-yea, Madaffer-yea, Inzunza-yea, Mayor Murphy-yea.

ITEM-31: Girl's Summit Day.

COUNCILMEMBER MAIENSCHEIN'S RECOMMENDATION:

Adopt the following resolution:

(R-2003-411) ADOPTED AS RESOLUTION R-297301

Proclaiming November 22, 2002 to be "Girl's Summit Day" in San Diego.

SUPPORTING INFORMATION:

Various agencies, government officials and community leaders in San Diego have recognized the importance of issues faced by girls in our city from age 10-20. These leaders have formed a working committee to sponsor a conference to address these issues. The Girls' Issues Group believes the state of health and well-being among the 300,000 girls ages 10-20 in San Diego County are in need of attention. More than one in five high school girls report sexual or physical abuse. Self-confidence and health ratings decline in high school for girls. The local Youth Risk Behavior Survey conducted by the San Diego Unified School District revealed that in 2001, 14% of girls attempted suicide. The Girl's Issues Group is hosting the Girl's Summit 2002 on November 22, 2002 to raise awareness of girls' issues among service providers. The City of San Diego supports Girl's Summit 2002 through obtaining a 20% discount in the cost of the San Diego Community Concourse for the Summit.

Maienschein/Ekard

FILE LOCATION: AGENDA

COUNCIL ACTION: (Time duration: 2:15 p.m. - 2:18 p.m.)

MOTION BY MAIENSCHEIN TO ADOPT. Second by Stevens. Passed by the following vote: Peters-yea, Wear-yea, Atkins-yea, Stevens-yea, Maienschein-yea, Frye-yea, Madaffer-yea, Inzunza-yea, Mayor Murphy-yea.

COUNCIL COMMENT:

ITEM-CC-1:

Deputy Mayor Stevens wished to comment that the Evans Family Inn at Torrey Pines was being honored in San Francisco that evening as a five star Hotel that is receiving five diamond points.

FILE LOCATION: MINUTES

COUNCIL ACTION: (Time duration: 6:02 p.m. - 6:03 p.m.)

ITEM-50: Approval of Ordinance amending the San Diego Municipal Code related to FY 2003 Negotiated Retirement Benefit Enhancements.

CITY COUNCIL'S RECOMMENDATION:

Adopt the ordinance which was introduced on 10/21/2002 (Council voted 9-0):

(O-2003-67 Cor. Copy) ADOPTED AS ORDINANCE O-19121 (New Series)

Amending Chapter II, Article 4 of the San Diego Municipal Code by amending Division 2 by amending Section 24.0201; by amending Division 3 by amending Section 24.0301; by amending Division 4 by amending Section 24.0402; by amending Division 5 by amending Section 24.0501; by amending Division 8 by amending Section 24.0801, and by Renumbering Section 24.0803 as Section 24.0802; by amending Division 12 by amending Sections 24.1201, 24.1202,

24.1203 and 24.1204; by amending Division 15 by amending Section 24.1507; all relating to the San Diego City Employees' Retirement System.

FILE LOCATION: MEET

COUNCIL ACTION: (Time duration: 2:31 p.m. - 2:53 p.m.)

MOTION BY INZUNZA TO DISPENSE WITH THE READING AND ADOPT THE ORDINANCE. Second by Madaffer. Passed by the following vote: Peters-yea, Wear-yea, Atkins-yea, Stevens-yea, Maienschein-yea, Frye-nay, Madaffer-yea, Inzunza-yea, Mayor Murphy-yea.

ITEM-51: Approval of Ordinance amending San Diego Municipal Code related to FY 2003 Negotiated Retirement Benefits.

CITY MANAGER'S RECOMMENDATION:

Introduce the following ordinance:

(O-2003-74) INTRODUCED, TO BE ADOPTED ON TUESDAY, DECEMBER 3, 2002

Introduction of an Ordinance amending the San Diego Municipal Code by amending Division 13 by amending Sections 24.1310 and 24.1312; by amending Division 14 by amending Sections 24.1402, 24.1403, and 24.1404; all relating to the San Diego City Employees' Retirement System.

CITY MANAGER SUPPORTING INFORMATION:

As a result of the recent contract negotiations with the Police Officers' Association, Fire Fighters Local 145, Municipal Employees Association, and AFSCME, Local 127, the City Management Team agreed to implement a number of revisions to the Retirement System. Ordinance O-2003-67 was introduced at the October 21, 2002 meeting of the City Council which amends the San Diego Municipal Code to reflect the majority of the revisions to the Retirement System negotiated during the FY 2003 Meet and Confer process.

However, Ordinance O-2003-67 did not include the revisions to the Retirement System (SDCERS) giving Members represented by Fire Fighters Local 145 the ability to convert Annual

Leave accrued after July 1, 2002 to service credit in SDCERS or extend their participation in the System's Deferred Retirement Option Plan ("DROP").

Ordinance O-2003-67 did not include a revision to the Retirement System removing the current prohibition against counting a purchase of service credit made pursuant to the General Provision for Five Year Purchase of Creditable Service set forth in San Diego Municipal Code Section 24.1312 towards the ten year vesting requirement set forth in Section 141 of the San Diego City Charter. This action will remove the prohibition and allow the purchase of creditable service to apply towards the ten year vesting requirement.

Effective July 1, 2002, represented Members in the Local 145 bargaining unit who have not yet entered DROP will be allowed to convert the cash equivalent of their Annual Leave accrued after July 1, 2002 to service credit in SDCERS or extend their DROP participation period.

Represented Members in the Local 145 Bargaining Unit will no longer be able to exercise any cash out feature of Annual Leave accrued after July 1, 2002. Represented Members in the Local 145 bargaining unit who have balances of Annual Leave accrued after July 1, 2002, will be allowed to extend their DROP participation period beyond the five year maximum by that amount of post July 1, 2002 Annual Leave still available and not converted to service credit prior to entering DROP. A vote of the Retirement System Members to approve these changes in this ordinance affecting Member benefits will take place from November 2002 through December 2002.

FISCAL IMPACT:

The conversion of Annual Leave to service credit in the Retirement System or extension of the Member's DROP participation period may result in an increase to the Retirement System's unfunded liability and a corresponding increase to the City's contribution rate over and above the scheduled rates in the Manager's Proposal.

The amount of any increase to the System's unfunded liability and City's contribution rate will depend upon the usage of Annual Leave accrued after July 1, 2002 that is converted to service credit in the Retirement System or to extend the Member's DROP participation period. There is no fiscal impact associated with the provision allowing 5 year purchase of service.

Herring/Lexin/DK

FILE LOCATION: NONE

COUNCIL ACTION: (Time duration: 2:31 p.m. - 2:53 p.m.)

MOTION BY INZUNZA TO INTRODUCE. Second by Madaffer. Passed by the following vote: Peters-yea, Wear-yea, Atkins-yea, Stevens-yea, Maienschein-yea, Frye-nay, Madaffer-yea, Inzunza-yea, Mayor Murphy-yea.

* ITEM-52: Office Space Sublease - Police Department Harbor Patrol Unit.

(Mission Bay Community Area. District-2.)

CITY MANAGER'S RECOMMENDATION:

Introduce the following ordinance:

(O-2003-77) INTRODUCED, TO BE ADOPTED ON TUESDAY, DECEMBER 3, 2002

Introduction of an Ordinance authorizing the City Manager to execute a Sublease agreement with WESCO Sales Corp., for the sublease of approximately 1,175 square feet, at a total monthly rental rate of $1,685.95, for an initial term of five (5) years with the option of two (2) additional three (3) year extensions;

Authorizing the City Auditor and Comptroller to expend an amount not to exceed $15,173.55, plus applicable CAM charges, from Police Department Fund 100 for FY2003.

NOTE: 6 votes required pursuant to Section 99 of the City Charter.

CITY MANAGER SUPPORTING INFORMATION:

The Police Department Harbor Patrol Unit provides policing enforcement for land and water at Mission Bay Park and has been located at Hospitality Point in Mission Bay Park since March 1986. During this period the Harbor Patrol Unit has occupied a temporary trailer facility for office space with portable restrooms. The Police Department has been in search of suitable office space that also provides convenient access to Mission Bay. As a result of the redevelopment at Dana Landing adequate office space has been located that also provides the desired water access. The sublease space will accommodate general office for law enforcement, related community activities and programs.

The Police Department is proposing to sublease the space under the following terms:

TERM-Five (5) years. Commencing October 1, 2002 or upon completion of tenant improvements, terminating September 30, 2007 or five (5) years from commencement date.
RENT-$1.10 per square foot or $1,292.50 per month base rent. Rental rate is less than similar commercial space in the area. The base monthly rent will be adjusted upwards on the sublease anniversary date by two (2) percent. The monthly rent of $1,292.50, plus $393.45 that will be paid for tenant improvements amortized over the Sublessee's initial five-year lease term, total $1,685.95 per month for the first year of the sublease agreement.
USE-General office for law enforcement, related community activities and programs.
SIZE-1,175 square feet.
OPTION TO EXTEND-The City has the option to extend the sublease for two additional three (3) year periods.

FISCAL IMPACT:

$15,173.55 will be paid from Police Department Fund 100 for the FY2003.

Herring/Griffith/DCM

Aud. Cert. 2300503.

FILE LOCATION: NONE

COUNCIL ACTION: (Time duration: 2:19 p.m. - 2:25 p.m.)

CONSENT MOTION BY MADAFFER TO INTRODUCE. Second by Maienschein. Passed by the following vote: Peters-yea, Wear-yea, Atkins-yea, Stevens-yea, Maienschein-yea, Frye-yea, Madaffer-yea, Inzunza-yea, Mayor Murphy-yea.

* ITEM-53: Office Space Lease - Police Department.

(Navajo Community Area. District-7.)

CITY MANAGER'S RECOMMENDATION:

Introduce the following ordinance:

(O-2003-78) INTRODUCED, TO BE ADOPTED ON TUESDAY, DECEMBER 3, 2002

Introduction of an Ordinance authorizing the City Manager to execute a lease agreement with CTF-I Mission, LLC, for the lease of approximately 3,828 square feet, at the initial monthly rental rate of $5,742, for a term of five (5) years;

Authorizing the City Auditor and Comptroller to expend an amount not to exceed $57,420, from Police Department Fund 100 for FY2003.

NOTE: 6 votes required pursuant to Section 99 of the City Charter.

CITY MANAGER SUPPORTING INFORMATION:

The Police Department has been leasing space at 3033 Fifth Avenue, Suite 205, since October 1998 as general office use by the Event Development and Management Unit (EDMU - formerly IACP). The lease terminates at their current location October 31, 2002. EDMU is seeking to co-locate with other units from the Special Services Division of the Police Department. A larger space at a more central location was found at 6151, Suite 205, and 6153, Suite 230, Fairmount Avenue in the Mission Gorge area. The lease space will accommodate general office administration for stadium event planning, special event planning, volunteer services, and critical incident management.

The Police Department is proposing to lease the space under the following basic terms:

TERM-Five (5) years. Commencing September 1, 2002, terminating August 31, 2007.
RENT-$1.50 per square foot or $5,742 per month. Rental rate is less than similar commercial space in the area. The base monthly rent will be adjusted on the lease anniversary date upwards by $0.05 per rentable square foot.
USE-General office administration for law enforcement.
SIZE-3,828 square feet.

EXHIBIT NO. 25

Report on Investigation

The City of San Diego, California's

Disclosures of Obligation to Fund the

San Diego City Employees' Retirement System

and Related Disclosure Practices

1996-2004

with

Recommended Procedures and Changes to the Municipal Code

September 16, 2004

Paul S. Maco
Richard C. Sauer
Vinson & Elkins L.L.P.
Washington, D.C.

No disclosure was made in the discussion of current and future City budgets either. Only in the cover letter to the City's CAFR, which is not included in the Official Statement, could a reader find information about the increased Retirement Benefit Calculation factor. To readers of City Official Statement, the admonitions and concerns of the Blue Ribbon Committee as to the need to appreciate the impact of additional benefits grants to future City budgets went fresh and unheeded. The City Manager's office was intimately familiar with the negotiations and aware of the Blue Ribbon report.

X. The Gleason Litigation

In January 2003, a class action suit was filed against the City and SDCERS relating primarily to alleged breaches of law and fiduciary duty in connection with the negotiated departures from actuarial funding represented by the two Manager's proposals. Two other suits followed, asserting additional violations relating to the City's relationship to its retirement system.[296] Among the allegations were:

- The City violated Section 143 of the City Charter by paying less than the actuarially required rate to SDCERS, and less than an amount substantially equal to that paid by employees;

- The City violated former SDMC Section 24.0801 by failing to pay the actuarially required rate;[297] and

- Certain SDCERS Board members violated the California Political Reform Act and Section 1090 of the California Government Code by agreeing to MP2 in order to obtain additional retirement benefits for themselves as members of the System.

No CAFR has been issued by the City after the instigation of these actions.[298] The City, however, described as follows the initial *Gleason* complaint (it was not a named party in the other two actions) in the various offering documents it issued subsequent to that filing:

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[296] *Gleason v. San Diego City Employees' Retirement System* (San Diego County Super. Ct.) (No. GIC 803779); *Gleason v. San Diego City Employees' Retirement System* (San Diego County Super. Ct.) (No. GIC 810837); and *Wiseman v. Board of Administration of the San Diego City Employees' Retirement System* (San Diego County Super. Ct.) (No. GIC 811756).

[297] That provision of the Municipal Code was amended in November 2002 to require that the City contribute to SDCERS in accordance with the schedule provided in MP2. Previously, it stated:

> Commencing July 1, 1954, the City shall contribute to the Retirement Fund in respect to members a percentage of earnable compensation as determined by the System's Actuary pursuant to the annual actuarial evaluation required by Section 24.0901.

[298] It is anticipated that the 2003 CAFR will be issued following the completion of a re-audit, presently in progress, of the City's financial statements for that fiscal year.

> On January 16, 2003, a class action complaint (*Gleason v. City of San Diego, et al.*) for declaratory relief was filed in the Superior Court against the City, the City's Employee's Retirement System (SDCERS), and certain named members of the SDCERS board of administration. The plaintiffs, former City employees who receive City retirement benefits, allege that as a result of recent actions taken by the defendants, the SDCERS trust fund has an unfunded accrued liability of $720 million, and that by 2009, the City will owe approximately $2.8 billion to SDCERS, with an annual City budget expense of more than $250 million. In addition to the declaration of their rights, plaintiffs ask for restitution to the SDCERS trust fund, an injunction prohibiting the City from unlawfully underfunding the trust fund in the future, money damages, attorney' fees, and other relief.[299]

SDCERS and the City litigated the matter for over a year, then, in August 2004, entered into a settlement with the plaintiff class on terms that bolstered the financial stability of the System. The settlement essentially obviated any future operation of the Manager's proposals, providing among other things:

- The City shall pay the full ARC (calculated under the PUC method) beginning FY 2006;[300]
- The City shall pay $130 million for its FY 2005 contribution to the system; and
- The City shall provide a total of $500 million in security interests in real property to secure its required contributions to SDCERS through FY 2008. The security interests will be released in the amount of $125 million annually through FY 2008 as the required contributions are made.

The agreement further provides that the amortization of the System's UAAL will be reset at June 30, 2004, based on a new 30 year period. However, after FY 2008, the City, absent an amendment to the City Charter, must contribute to SDCERS at the rates calculated by the SDCERS actuary and approved by the SDCERS Board. This may involve changed actuarial assumptions or yet another, and potentially shorter, amortization period.[301] A shorter amortization period would, at least initially, act to increase the City's contribution rate.

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[299] *See, e.g., Official Statement, City of San Diego/MTDB Authority, 2003 Lease Revenue Refunding Bonds*, April 30, 2003, at A-38.

[300] Accordingly, the City agreed to repeal the provisions of Municipal Code ch. 2, art. 4, div. 2, § 24.0801 that conformed the City's contribution obligations to the payment schedule contained in MP2.

[301] We understand that a rolling 15-year amortization period is contemplated. A rolling amortization period, which is acceptable under GASB standards, results in the employer paying a set fraction (here 1/15) of the UAAL every year. Thus the UAAL is never extinguished, unless as a result of factors other than the amortization mechanism.

EXHIBIT NO. 26

1-1.1 C

NORMAN T. SELTZER
ROBERT CAPLAN
GERALD L. MCMAHON
REGINALD A. VITEK
STEPHEN DOUGLAS ROYER
DAVID J. DORNE
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February 12, 2003

Lawrence B. Grissom, Retirement Administrator
Loraine E. Chapin, Esq., General Counsel
San Diego City Employee's Retirement System
401 B Street, Suite 400
San Diego, CA 92101

Re: James F. Gleason, et al. v. San Diego City Employees' Retirement System, et al.
San Diego Superior Court Case No. GIC 803779
Our File No. 07835.56570

Dear Ms. Chapin and Mr. Grissom:

1. Engagement

This letter sets forth the basis on which you will engage this law firm to represent San Diego City Employee's Retirement System ("SDCERS") with respect to the above-referenced matter. The matter involves a lawsuit brought by two retired San Diego City employees, purportedly on behalf of an alleged class of similarly situated San Diego City employees, against the City of San Diego, SDCERS, and certain members of the Board of SDCERS, including Frederick Pierce, IV, John Torres, John Casey, David Crow, Mary Vattimo, Ron Saathoff, Terri Webster, Sharon Wilkinson, Dick Vortmann, and Ray Garnica (collectively: "the Individual Defendants"). The lawsuit alleges the City of San Diego violated certain sections of its charter, as well as related sections of the City of San Diego Municipal Code, by failing and refusing to contribute actuarially appropriate amounts to SDCERS. The lawsuit further alleges SDCERS and the Individual Defendants breached fiduciary duties owed to the plaintiffs by adopting an improper and unauthorized funding method. The lawsuit seeks declaratory relief, restitution from the City of San Diego of all amounts owed to SDCERS as a result of past violations, injunctive relief prohibiting further unlawful underfunding, money damages for retirement benefits which would have been paid to the purported plaintiff class but for the alleged violations, money damages from the Individual Defendants for damages

proximately caused by their alleged breach of fiduciary duty, and removal of the Individual Defendants from the Board of SDCERS.

2. **Disclosure of Potential Conflicts of Interest**

California Rule of Professional Conduct 3-310, subdivisions (B)(1) and (3)[1] require that we disclose the following information before we are engaged to represent SDCERS in this matter:

1. Thomas F. Steinke, Esq., a member of this law firm, is a former San Diego City Attorney, and is therefore a potential member of the plaintiff class. It is possible that, should plaintiffs obtain some form of actual or inchoate monetary relief, Mr. Steinke would share in such recovery. Mr. Steinke will not perform any work on this matter. We will take all reasonable steps necessary to prevent any information obtained by this firm from being disclosed to Mr. Steinke.

2. Norman T. Seltzer, Esq., and Daniel E. Eaton, Esq., both of whom are members of this firm, hold positions in their individual capacities with the City of San Diego Civil Service Commission. We understand that, from time to time, representatives of SDCERS appear before the San Diego Civil Service Commission. We are not aware of any potentially adverse consequences that may arise based on this information.

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[1] California Rule of Professional Conduct 3-310, subdivision (A)(1), defines "Disclosure" as "informing the client or former client of the relevant circumstances and of the actual and reasonably foreseeable adverse consequences to the client or former client."

Subdivision (B)(1) states: "A member shall not accept or continue to representation of a client without providing written disclosure to the client where: [¶] (1) The member has a legal, business, financial, professional, or personal relationship with a party or witness in the same matter."

Subdivision (B)(3) states: "The member has or had a legal, business, financial, professional, or personal relationship with another person or entity the member knows or reasonably should know would be affected substantially by resolution of the matter."

3. Mike Leone, a member of this law firm, was married to SDCERS Associate General Counsel Sheila Leone. The two have been divorced for several years and there is no longer any financial relationship whatsoever, including, but not limited to, spousal support, between the two. Mr. Leone will assist me in representing SDCERS in this matter.

We do not undertake to represent, or render any form of legal services to, the Individual Defendants. As we advised you in our first meeting, the Individual Defendants should seek, and obtain, separate representation for so long as they remain defendants in this action.

3. <u>Attorneys' Services, Fees and Costs</u>

It is difficult to predict with any reasonable degree of accuracy the nature and extent of legal services to be performed. We therefore have not made any commitment as to a maximum amount for fees or costs or as to the outcome of the matter.

SDCERS agrees to pay the usual fees charged from time to time by the persons in our firm (other than myself) who work on this matter. My current hourly rate is $450. Mike Leone also will be working on this matter. Mr. Leone's hourly rate is $325. Other hourly rates which vary according generally to levels of experience are as follows: Senior members of the firm, $290 to $485; Associates and Of Counsel attorneys, $150 to $425; Paralegals, $95 to $130; Law Clerks, $150 to $210; Word Processing, $40 to $55; and Document Control Clerks, $25 to $40. Our hourly charges shall include time spent on the telephone, performing legal research, conferring with persons who may have relevant information, negotiating for settlement, in court or in related proceedings, and performing all other services on your behalf. If our firm adopts new usual hourly rates from time to time during the course of our representation, later charges will be billed and payable at such rates. No new rates will be adopted before January 1, 2004.

Independent of and in addition to the fees for legal services to be rendered on SDCERS' behalf, it may be necessary for our firm to incur costs and advance sums for items such as filing fees, process service fees, deposition transcripts, photocopying at 20¢/pg. if done in-house, expert witness' fees, investigator's fees, long-distance telephone charges, facsimile transmission charges at $1/pg. plus any long-distance telephone charges, travel expenses and other charges. We may

request that SDCERS advance such costs; however, to the extent that our firm advances such costs on its behalf, it is agreed that SDCERS will reimburse us monthly and hold us harmless from liability for these costs. Certain vendors may be billing SDCERS directly for services performed at our request. We, of course, will identify all such vendors to SDCERS.

4. **Billing Statements and Correspondence**

We will send our detailed monthly statements addressed to San Diego City Employees' Retirement System, 401 B Street, Suite 400, San Diego, California 92101, Attn: Sheila Leone, Esq., indicating the current status of SDCERS' account, both for services rendered and for costs advanced. The statements will show the date of each service performed, who performed it, the time expended and rate involved. The statements will be due and payable in full monthly upon billing.

Our practice is to furnish our clients with copies of pleadings and/or correspondence and to give verbal or written status reports from time to time concerning progress of a case. We will send all such copies and make all such reports to Sheila Leone, unless we are requested in writing to do otherwise. We will take instructions in this matter from Sheila Leone, unless we are requested in writing to do otherwise.

We have not required that SDCERS deposit with us an initial retainer amount. We reserve the right to review this decision from time to time to determine whether or not a retainer amount for this matter is appropriate.

5. **Arbitration Provision**

Concurrent with this Agreement, SDCERS agree to and enter into the Arbitration Agreement attached as Exhibit "A," by which SDCERS and this firm agree that any controversy, claim or dispute which arises from or relates to this agreement or services rendered or to be rendered by this firm (including its attorneys and employees) shall be determined exclusively by submission to mandatory, binding arbitration, instead of by a lawsuit or resort to court action.

6. **Potential Insurance Coverage**

Although it is doubtful the claims asserted in this matter will be covered by insurance, if SDCERS wants us to analyze the potential for such insurance

coverage, it must so advise us in writing and provide us copies of all such insurance policies that may be applicable. Any delay in having SDCERS' insurance reviewed or providing copies of such policies may cause SDCERS to lose legal rights.

Our engagement is solely by SDCERS. Accordingly, we shall not be bound to whatever rates or guidelines any applicable insurance carrier(s) employ. Naturally, if we receive any funds payable to our firm from any carrier(s), we will apply them as credits to SDCERS' account. Nothing in this letter or our engagement is intended to confer third-party beneficiary status on any person or entity.

7. Other Provisions

We have not been engaged to provide tax advice concerning this claim, including without limitation the deduction of costs associated with litigation.

Naturally, once our file has been closed, we will not perform any services on SDCERS' behalf concerning this matter. Thereafter, unless otherwise requested and agreed in writing, we will not notify SDCERS of changes in the law which may affect it or its interests with respect to this matter.

No change, waiver or modification of any of the provisions of this agreement shall be effective unless in writing and signed by our firm. This letter contains our entire agreement concerning the services we will be performing and our compensation for such services and costs. We have made no representations or promises other than those expressly set forth in this agreement.

Should SDCERS ask us to render additional legal services of the same general kind as requested in this matter, and should we agree to undertake them, and if no new written fee agreement is entered into, the terms and conditions of this agreement shall control our engagement for any such additional services.

Moreover, we wish to advise SDCERS that it is the policy of our firm to destroy papers in files any time after 10 years from the conclusion of a matter. If for any reason SDCERS wishes to preserve any of the records or files from this matter, please request them from our office well before this time period elapses.

To confirm our agreement under the terms and conditions set forth above, please sign and return a copy of this letter to us on or before February 20, 2003.

We look forward to working with you.

Very truly yours,

SELTZER CAPLAN McMAHON VITEK
A Law Corporation

By: _____
Reg A. Vitek, Vice President

RAV/MAL:bs
Enclosure

APPROVED AND ACCEPTED:

SAN DIEGO CITY EMPLOYEE'S RETIREMENT SYSTEM

Dated:_____, 2003

By:_____
Lawrence B. Grissom,
Retirement Administrator

APPROVED AND ACCEPTED:

SAN DIEGO CITY EMPLOYEE'S RETIREMENT SYSTEM

Dated:_____, 2003

By:_____
Loraine E. Chapin, Esq.
General Counsel

EXHIBIT "A"

ARBITRATION AGREEMENT

THE UNDERSIGNED AGREE THAT ANY CONTROVERSY, CLAIM OR DISPUTE WHICH ARISES FROM OR RELATES TO THE ENGAGEMENT OF OR SERVICES RENDERED OR TO BE RENDERED BY SELTZER CAPLAN McMAHON VITEK (INCLUDING ITS ATTORNEYS AND EMPLOYEES) (COLLECTIVELY "THE LAW FIRM") SHALL BE DETERMINED EXCLUSIVELY BY SUBMISSION TO MANDATORY, BINDING ARBITRATION, INSTEAD OF BY A LAWSUIT OR RESORT TO COURT ACTION. SUCH DISPUTES MAY INCLUDE, WITHOUT LIMITATION, DISPUTES AS TO FEES, COSTS OR PROFESSIONAL MALPRACTICE (THAT IS, AS TO WHETHER ANY LEGAL SERVICES RENDERED WERE UNNECESSARY OR UNAUTHORIZED OR WERE IMPROPERLY, NEGLIGENTLY OR INCOMPETENTLY RENDERED).

THE PARTIES TO THIS AGREEMENT, BY ENTERING INTO IT, ARE GIVING UP THEIR CONSTITUTIONAL RIGHTS TO HAVE ANY SUCH CONTROVERSY, CLAIM OR DISPUTE DECIDED IN A COURT OF LAW BEFORE A JURY, AND INSTEAD ARE ACCEPTING THE USE OF ARBITRATION. ACCORDINGLY, ("CLIENT") OR (COLLECTIVELY, "CLIENTS") ARE ADVISED TO OBTAIN THE ADVICE OF INDEPENDENT COUNSEL BEFORE ENTERING INTO THIS AGREEMENT.

ANY ARBITRATION PROCEEDING UNDER THIS AGREEMENT SHALL BE CONDUCTED IN SAN DIEGO, CALIFORNIA, IN ACCORDANCE WITH THE COMMERCIAL ARBITRATION RULES OF THE AMERICAN ARBITRATION ASSOCIATION (AAA) AND GOVERNED BY THE LAWS OF THE STATE OF CALIFORNIA PERTAINING TO BINDING ARBITRATION. THE CLIENTS AND THE LAW FIRM SHALL CAUSE A SINGLE ARBITRATOR TO BE SELECTED UNDER THE AAA's COMMERCIAL ARBITRATION RULES AND SHALL SHARE THE ARBITRATOR'S FEES EQUALLY. THE ARBITRATOR'S DECISION SHALL BE CONCLUSIVE, FINAL AND BINDING UPON THE PARTIES. JUDGMENT ON THE DECISION MAY BE ENTERED IN ANY COURT OF COMPETENT JURISDICTION. NEITHER PARTY MAY SEEK AN APPEAL OR REVIEW OF THE ARBITRATOR'S DECISION EXCEPT UPON THE GROUNDS SPECIFIED IN CALIFORNIA CODE OF CIVIL PROCEDURE SECTIONS 1285 AND FOLLOWING.

NOTICE: BY SIGNING THIS CONTRACT, THE PARTIES ARE AGREEING TO HAVE ANY AND ALL CONTROVERSIES, CLAIMS AND

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DISPUTES ARISING BETWEEN THEM DECIDED BY A NEUTRAL ARBITRATOR AND ARE GIVING UP THEIR RIGHTS TO A JURY OR COURT TRIAL.

SELTZER CAPLAN McMAHON
VITEK, A Law Corporation

Dated: 2-13, 2003 By _____
Reg A. Vitek, Vice President

SAN DIEGO CITY EMPLOYEE'S
RETIREMENT SYSTEM

Dated: _____, 2003 By: _____
Lawrence B. Grissom,
Retirement Administrator

SAN DIEGO CITY EMPLOYEE'S
RETIREMENT SYSTEM

Dated: _____, 2003 By: _____
Loraine E. Chapin, Esq.
General Counsel

bcc: Ms. Wendy Whitemore
Accounting Department (w/ notations regarding additions or deletions affecting billing, i.e. retainer, special rates, word processing fees, late charges, etc.)

EXHIBIT NO. 27

From: Sheila Leone
Sent: Wednesday, February 19, 2003 8:34 AM
To: LGrissom
Cc: LChapin; PBarnett; RParks
Subject: Gleason

Larry, I expect an email from Seltzer Caplan today outlining what should be stated in Friday's closed session re: Gleason. I spoke with Reg Vitek this morning. The present strategy is to stress the importance of privilege and non-waiver of privilege, with the idea that the attorneys for the City, Retirement System and Board members will meet and decide how best to proceed. The System's answer is not due until March. Reg intends to set a meeting with us after he meets with Rick Roeder (tomorrow) and speaks with Bob Blum. I'll forward his email. Thanks. S

EXHIBIT NO. 28

NORMAN T. SELTZER
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SELTZER | CAPLAN | McMAHON | VITEK
A LAW CORPORATION

March 5, 2003

VIA HAND DELIVERY

Sheila Leone, Esq.
San Diego City Employees'
Retirement System
410 B Street, Suite 400
San Diego, CA 92101

Re: San Diego City Employees' Retirement System, et al. adv. James F. Gleason, et al. - Initial Litigation Evaluation and Recommendations
San Diego Superior Court Case No. GIC 803779
Our File No. 7835.56570

Dear Sheila:

We have now had an opportunity to conduct an initial review and evaluation of certain documents pertaining to actions taken by the San Diego City Employees' Retirement System ("SDCERS"), by and through its individual board members ("the Individual Defendants") which serve as the factual foundation of the *Gleason* litigation. The categories of documents we have reviewed include:

(a) The *Gleason* complaint;

(b) Correspondence to and from SDCERS' fiduciary counsel regarding the 1996 City Manager's Retirement Proposal ("the '96 Agreement");

(c) Memoranda from the City of San Diego City Manager's Office regarding the '96 Agreement;

(d) Memoranda from the City Manager's Office regarding the City Manager's May 2002 contribution reduction proposal ("the '02 Proposal");

(e) Draft and final correspondence, and presentation materials, from SDCERS' fiduciary counsel regarding the '02 Proposal;

(f) SDCERS Staff Report regarding the '02 Proposal;

(g) Correspondence and presentation materials prepared by SDCERS' actuary regarding the '02 Proposal;

(h) Minutes of the SDCERS Board of Directors meetings on September 20, 2002, and November 15, 2002;

(i) Transcripts of the SDCERS Board of Directors meetings on June 21, 2002, July 11, 2002, and November 15, 2002;

(j) Agreement dated November 18, 2002, regarding Employer Contributions between the City of San Diego and SDCERS, including related resolutions regarding defense and indemnity of the Individual Defendants;

(k) Draft report on the Mayor's Blue Ribbon Committee on City Finances, dated January 15, 2003, including SDCERS staff response, and final version of "Blue Ribbon Committee" report, dated February 11, 2003.

We have also interviewed SDCERS' actuary, Rick Roeder, and spoken briefly with its fiduciary counsel, Bob Blum, Esq. We will meet with Mr. Blum to discuss his knowledge of the facts involved in this case on March 13, 2003. Finally, we have performed preliminary legal research to familiarize ourselves with the law governing SDCERS' rights, duties and obligations regarding the conduct at issue in the *Gleason* litigation.

Based on the foregoing sources of information, as well as our informal discussions with SDCERS staff, this letter will provide you with our initial analysis and recommendations regarding the defense of SDCERS in the *Gleason* litigation. As you know, our engagement is limited to representation of SDCERS, and does not include *any* of its board members, whether such board members are among the class of Individual Defendants or not. Moreover, our analysis, conclusions and recommendations are made exclusively from our perspective as litigation counsel. While we understand the *Gleason* litigation implicates highly politicized issues, our analysis does not take such factors into account, and instead focuses solely on what we believe is the litigation strategy mostly likely to achieve the best possible result for SDCERS.

Summary of Conclusions and Recommendations

Our conclusions and recommendations, as set forth in detail in this letter, are:

1. The Individual Defendants breached their fiduciary duty by adopting the '02 Proposal in its modified form because it resulted in a lower contribution obligation by the City, as well as an increase in vested liabilities, without any basis for accepting the City's contention that it would meet its increased contribution obligations in the final years covered by the '02 Proposal. It is unclear whether plaintiffs are asserting a breach of fiduciary duty by SDCERS, as contrasted with its Board.

2. The Individual Defendants subordinated SDCERS' interests to the interests of themselves, their unions, and the City.

3. SDCERS Staff should recommend to the Board that it exercise its right under the November 18, 2002 Agreement to "nullify this Agreement to the extent required by its duties established under the California Constitution..."

4. Notwithstanding the foregoing conclusions, SDCERS may be immune from liability for the acts alleged in the complaint under Government Code section 815.2. Depending on the strategy adopted after discussion between SDCERS and its litigation counsel, the initial responsive pleading may be a demurrer to the Complaint seeking dismissal of the action against SDCERS on the grounds it is immune from liability.

5. In the event it is necessary to answer the Complaint in the *Gleason* litigation, SDCERS should consider filing a cross-complaints against the City of San Diego and the labor unions whose leadership voted for the '02 Proposal, alleging a conspiracy between the City and Unions to cause the Board members to breach their fiduciary duties to SDCERS' members and their beneficiaries.

6. SDCERS should adopt a litigation strategy in the *Gleason* litigation designed to cause the City to honor its contribution obligations under the '96 Agreement.

Summary and Analysis of the Facts

B. The '96 Agreement.

In or about June 1996, the City Manager proposed an "Employer Contribution Rate Stabilization Plan," under which contribution rates would be calculated using the projected unit credit (PUC) actuarial method, with specified contribution rates in the ensuing two fiscal years of 7.08% and 7.33%. Thereafter, the contribution rate would increase by 0.50% each year until the contribution rate reached the rate calculated on the basis of the entry age normal (EAN) actuarial method. Significantly, the City Manager's proposal specified:

> "In the event that the funded ratio of the System falls to a level 10% below the funded ratio calculated at the June 30, 1996 actuarial valuation...the City-paid rate will be increased on July 1 of the year following the date of the actuarial valuation in which the shortfall in funded ratio is calculated. The increase in the City-paid rate will be the amount determined by the actuary necessary to restore a funded ratio no more than the level that is 10% below the funded ratio calculated at the June 30, 1996 actuarial valuation."

The City Manager's stated reason for presenting the "Rate Stabilization Plan" was the unanticipated fluctuations in the Employer's Contribution Rate under the projected unit credit actuarial method adopted by the City in 1992. Thus, all parties knew the City Manager's proposal was intended to effect changes to the retirement system *for the benefit of the City.*

The question of whether the Board would be discharging its fiduciary duties in adopting the '96 Agreement was submitted to fiduciary counsel for an opinion. Counsel noted that nothing in the proposal "changes the Board's discretion to adjust the actuarial assumptions on which the System is based as needed in order to insure the long term funding integrity of the System." Counsel concluded:

> "Provided the City-paid rate in the [Plan] is not less than an amount substantially equal to that required of employees for normal retirement allowances as certified by the actuary, the Board will be acting within the discretion granted to the Board to

> administer the System and discharging its fiduciary duties set forth in Article XVI, Sec. 17 of the California Constitution."

In response to questions from members of the Board, fiduciary counsel issued a second opinion addressing the System's duties under *Claypool v. Wilson* (1992) 4 Cal.App.4th 646, and related cases, to ensure that the modification of vested pension rights which would result from adoption of the City Manager's proposal were "offset" by an "increase in benefits and other advantages granted to the beneficiaries" of the System. Counsel noted that other aspects of the City Manager's proposal conferred increased benefits on the System's members. This, combined with the conclusion that "stabilization of employer contribution rates is directly related to the functioning and integrity of the system, led counsel to conclude the Board was acting in a manner consistent with its duties under *Claypool*.

In its second opinion letter, fiduciary counsel addressed two additional issues raised by Board members, which remain relevant to the current litigation. First, counsel noted the Board is held to the standard of professional bankers and bank investment advisors, and therefore has "a duty to determine the financial viability of the City before it approves contribution payments at a level less than that recommended by the actuary." Failure to carry out this duty, counsel noted, would be a breach of fiduciary duty. After reviewing the available information, counsel concluded a process existed through which the Board could satisfy itself of the City's financial viability.

Next, counsel noted that, because "the Board has no authority to determine benefits or to make benefit changes," it "should not engage in negotiations for benefit changes or increases." Nonetheless, certain Board members inquired as to whether the "real conflict" presented by Board members voting on proposals which would confer financial benefits on themselves would prevent those Board members from voting on the proposal. Fiduciary counsel noted that the City Manager's proposal made adoption of increased benefits contingent on approval of reduction of the City's funding obligation. However, counsel noted the drafters of the City Charter through which SDCERS was established "were aware of possible conflicts of interest inherent in the appointment of those [financially interested] members of the Board." Under these circumstances, counsel opined, the "bare potential for a conflict of interest does not categorically bar a fiduciary from functioning as a trustee." On this basis, counsel concluded:

> "[I]t is our opinion that those Board members who voted in favor of the proposal solely in the interest of, and for the exclusive purposes of providing benefits to participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system, did not have a conflict of interest sufficient to bar him or her from functioning as a trustee."

According to Mr. Roeder, the performance of relevant financial markets during the 1996 through 2000 time frame caused the funding ratio to far exceed the "trigger" established by adoption of the '96 Agreement. Mr. Roeder noted it was generally accepted that the funding ratio trigger was 82.3%, but because the funding ratio never approached that level, certain potential ambiguities in the '96 Agreement were never resolved.

C. <u>The 2002 City Manager's Proposal.</u>

On June 10, 2002, the City Manager, on behalf of the Mayor and City Council, requested that SDCERS approve an amendment to the '96 Agreement as follows:

> "The floor for the actuarial funded ratio of SDCERS will be established at 75%.
>
> The City will pay contributions at the 'agreed to' rates for FY96 through FY07 as contained in the Manager's Proposal. If the actuarial funded ratio falls below the floor in any year, the City will increase its contribution rate on July 1 of the following year by an amount equal to one-fifth of the amount necessary to reach the full actuarial rate. The City will pay this increased amount for each of the subsequent for years in order to achieve the full actuarial rate over a five year period."

The City Manager identified as the basis for the proposed amendment several "unprecedented events" during the preceding two years, including 9/11, "the collapse of the dot com industry," the "overall fall in the investment market," the "specific loss of revenues in the San Diego economy, and the anticipated raid on local revenues by the State of California."

During the following week, SDCERS requested an opinion from its current fiduciary counsel, Bob Blum, Esq., as to whether adoption of the City Manager's proposal was consistent with the Board's fiduciary duties. In an unsigned draft opinion letter dated June 12, 2002, Mr. Blum summarized the circumstances which led to the City Manager's proposal, including: the total of contributions by the City and members to SDCERS was insufficient to cover the normal cost and interest on past service cost computed at the actuarial funding rate; from July 1996 to June 2002, the difference between actual City contributions and actuarially calculated contributions totaled approximately $90 million; and, "it is estimated that as of June 30, 2002, SDCERS funding ratio will be close to 82.3%."

Mr. Blum noted that since the '96 Agreement was executed, the law governing employees' interests in their retirement system had been "substantially strengthened," thus limiting the ability of employers to alter contribution obligations in a manner that affected vested benefits. Moreover, Mr. Blum noted that the ability to "mitigate" funding reductions through provision of "comparable new benefits" was "not governing with respect to the Board's responsibility to act prudently. If it were governing then each time that employer persuaded a Board to reduce contributions, it could avoid challenges by increasing benefits. That would not pass elementary actuarial requirements." Significantly, Mr. Blum noted that one of the questions left unanswered by the City Manager's proposal was the means by which the City would fund its contribution obligation under the proposed modification to the '96 Agreement.

After more than a dozen pages of analysis, counsel concluded:

> "Under the facts as we understand them, and for the reasons discussed above, *it is our opinion that there is a material risk that if the Board were to agree to the proposed amendment to the Manager's Proposal in its current form, and if this decision were challenged in court, a court would hold that the decision was not a proper exercise of the Board's fiduciary responsibilities based upon the facts before the Board and the actuaries [sic] opinion to the contrary.* A court would look at whether the Board had substantial evidence to support the propriety of its actions and there is a material risk that a court would find such evidence lacking." (Emphasis added.)

Also on June 12, 2002, SDCERS' actuary, Rick Roeder, made a presentation to the Board which was highly critical of the '02 Proposal. Among the most important points Mr. Roeder made were the fundamental inconsistency, from SDCERS' point of view, between the "enhanced benefits" aspect of the proposal, and the "contribution relief" aspect of the proposal. Mr. Roeder also laid out the following facts, which he felt were relevant to the Board's decision:

(a) SDCERS' role should be largely independent of the setting of existing or potential benefit levels;

(b) Existing benefits for City employees were not below average compared to other state and national public systems;

(c) SDCERS is one of the few retirement systems to use PUC funding, and on that basis has one of the lowest funded ratios in California; moreover the existing funded ratio is at its lowest point since the 1980's; and

(d) The gap between the computed PUC actuarial rate and the city contribution rate has been increasing since implementation of the '96 proposal.

Mr. Roeder also noted several mitigating factors. Foremost among them, it appears, was that SDCERS would "be able to make benefit payments over the next 10-15 years regardless of the decision made to grant potential additional funding relief."

In his presentation to the Board, Mr. Roeder stated, "What the City proposes is outside the norm for generally accepted actuarial funded policies," a circumstance which he felt "place[d] an added burden in our view as trustees to exercise our fiduciary responsibility appropriately." Mr. Roeder stated that if the Board was "willing to accept this version of the manager's proposal, I want everyone here to be totally cognizant of the fact that the way I understand the current version is it will [be] possible for the funded ratio to go below 75 percent and possibly significantly below." Finally, Mr. Roeder made clear he was more comfortable with the initial manager's proposal because of the "hard floor" of 82.3%

Transcripts of the June 2002 hearing indicate a difference of opinion existed among both Board members and Staff regarding the proper interpretation of the '96 Agreement's "catch-up" provisions; particularly, whether the entire underfunded

amount came due in the immediately following year, or whether some longer term applied. Mr. Blum, along with Mr. Roeder, noted that under reasonably anticipated circumstances, a one-year catch-up provision would require the City to contribute approximately $75 million in FY03, if the funded ratio fell below 82.3%, as it was expected to do.

On June 18, 2002, the City Manager issued a memorandum to SDCERS purporting to respond to concerns raised by Mr. Blum in his June 12 draft correspondence. There appears to have been no attempt to respond to Mr. Roeder's concerns as expressed in his presentation. Significantly, despite Mr. Roeder's concerns over "dropping the hard floor" from 82.3% to 75%, the City Manager's memorandum left that provision unchanged. Additionally, the City Manager responded to Mr. Blum's concern regarding "funding status and anticipated earnings" over the later stages of the '02 Proposal's life by stating:

> "This is a very broad question which includes the work initiated by the Mayor's Blue Ribbon Committee on City Finances, the SDCERS subcommittee on surplus earnings and contingent benefits, and the need to develop a long term funding policy. It is recommended that a plan and schedule be developed to complete this policy work."

The only substantive modification to the original proposal was an increase in the City's "agreed contribution rate" from 0.50% to 1.00% effective July 1, 2004. This proposal is, at the very least, puzzling in light of the City Manager's non-response to Mr. Blum's questions concerning financing, and the City's purported justification for seeking contribution reduction in the first place, i.e., that it expected the State to "raid" City revenue sources beginning in 2004, thus worsening its short-term financial outlook.

On July 3, 2002, the City Manager provided SDCERS with another memorandum "clarifying" the terms of the proposal, as well as responding to concerns by Board members. Significantly, the City Manager's "clarification" made clear that the City had agreed to increased benefits for its employees during labor negotiations, "contingent" upon SDCERS accepting a reduction of its contribution obligation; yet in response to a Board member's question as to why SDCERS was placed in the middle of labor negotiations, the City Manager denied such a thing had occurred. Also significant was the City Manager's response to the Board's question of "why

we should assume the City will find it easier to pay much higher pension costs in the future:"

"It will not be easier nor desirous, just necessary."

No further information was provided as to how the City would meet the contribution obligation outlined in its proposal.

On July 11, 2002, another Board meeting was held at which SDCERS' fiduciary counsel provided an analysis of the effect of the "changes" the City offered in an effort to gain acceptance of the '02 Proposal. Mr. Roeder made clear at the July 11 meeting that the 82.3% trigger would be hit in June 2003. Thereafter, the Board devoted its discussion to the difference in funding obligations between competing interpretations of the '96 Agreement and the '02 Proposal. After lengthy and detailed discussions, Mr. Saathoff proposed that the 75% trigger in the '02 Proposal be replaced with the existing 82.3% trigger. Additionally, the modified proposal would incorporate the provision in the original '02 Proposal giving the City five years after the trigger was hit to "reach the full actuarial rate."

In the final minutes of what was a very long meeting, before a vote was taken, the Board asked both Mr. Roeder and Mr. Blum whether adopting the proposal was "a prudent exercise of our responsibility." Mr. Roeder appears to have responded that the final version of the proposal fell somewhere between the '96 Agreement and the original '02 Proposal. Mr. Blum stated it was difficult to give "an on-the-fly opinion," before concluding:

> "I can tell you it's a lot easier to give an opinion that you would not be at material risk. Exactly how far that opinion can go, exactly what the words are, that's a little difficult to tell you because we don't have the facts."

A vote was taken immediately thereafter, in which the modified '02 Proposal passed 8 to 2, with one abstention.

On November 5, 2002, Mr. Roeder provided certain written "statements in regard to the amendment to the Manager's Proposal." From the perspective of the current litigation, the most significant statements Mr. Roeder made were:

> "(c) It is likely that the 82.3% trigger point will be hit by June 30, 2003,..."
>
> "(d) The higher the City's contribution levels, the better the funding status of SDCERS..."
>
> "(g) From a pure actuarial viewpoint, it would be best to hold the City to the existing Manager's Proposal and the 82.3% trigger (particularly if one of the two 'high contribution rate' interpretations of the effects of hitting the trigger were to prevail)."

Mr. Roeder's letter did not include any statement to the effect that adoption of the modified '02 Proposal conformed to generally accepted actuarial principles, or that it was a prudent exercise of the Board's fiduciary responsibility.

On November 15, 2002, Mr. Blum reported to the Board on the results of his negotiation with City representatives on the provisions of the Memorandum of Understanding that set forth the final terms of the modified '02 Proposal. The Board discussion centered on assumptions underlying the exemplar calculations in the Memorandum of Understanding. Additionally, the first mention was made of "indemnification" of the Board by the City from unspecified consequences of adopting the modified '02 Proposal. Transcripts of the hearing indicate the discussion became extremely contentious and acrimonious. It appears from both the minutes and transcript that the Board concluded Mr. Blum essentially supported adoption of the MOU because the Board had engaged in prolonged and difficult evaluation of the proposal before adopting it. However, at least one Board member acknowledged that Mr. Roeder was "hesitant" to endorse the proposal. Mr. Roeder confirmed this interpretation of his feelings, stating that he felt it was "inappropriate" and placed the Board in "a no-win situation" of evaluating a contribution relief proposal that was linked to enhanced benefits for members. Nonetheless, the Board voted to adopt the MOU.

On November 18, 2002, Mr. Blum provided SDCERS with a signed opinion letter, containing an extensive, albeit retrospective, summary and analysis of the Board's decision to approve the modified '02 Proposal. Mr. Blum summarized the Board's decision as follows:

> "In essence, the Board decided to trade potential controversy over the meaning of the current Manager's Proposal and the possibility of receiving substantially higher contributions from the City if the

> 82.3% trigger is met in exchange for materially higher contributions if the trigger is not hit, lower contributions in the first five years if the trigger is hit, a date certain when the full PUC rate is contributed, and agreement on rapid movement to EAN starting at the end of the transition period."

Despite Mr. Roeder's multiple criticisms of the '02 Proposal (see page 11), Mr. Blum's only mention of Mr. Roeder's analysis was that the "transition period of moving the City to full PUC rates and then to EAN rates is reasonable based on the terms of the Agreement." Mr. Blum's reference to this limited aspect of Mr. Roeder's overall conclusion is puzzling, since Mr. Roeder explicitly stated that "from a purely actuarial viewpoint," he preferred there be no transition period.

On November 18, 2002, SDCERS executed the Agreement adopting the modified '02 Proposal. Significantly, the recitals included a statement that SDCERS recognized that "under current fiscal circumstances, undue hardship would be imposed on the City if the Board were to require that the City immediately increase its contributions to the full projected unit credit rate calculated by SDCERS' actuary." Also significant was a previously little-discussed provision allowing the Board to "nullify this Agreement to the extent required by its duties established under the California Constitution and no one shall have any liability for losses or costs on account of such action."

On the same date, SDCERS and the City executed an indemnity agreement, which provided "the City shall defend, indemnify and hold harmless all past, present and future members of the Retirement Board against all expenses, judgments, settlements, liability and other amounts actually and reasonably incurred by them in connection with any claim or lawsuit arising from any act or omission in the scope of the performance of their duties as Board Members under the Charter."

Summary of the Litigation

D. The Complaint.

The *Gleason* litigation was filed by attorney Michael Conger on January 16, 2003. Plaintiffs are by two retired San Diego City employees, purportedly acting on behalf of an alleged class of similarly situated retired San Diego City employees. Defendants are the City of San Diego, SDCERS, and certain members of the Board of SDCERS, including Frederick Pierce, IV, John Torres, John Casey, David Crow, Mary Vattimo, Ron Saathoff, Terri Webster, Sharon Wilkinson, Dick Vortmann, and Ray Garnica (collectively: "the Individual Defendants").

The lawsuit alleges the City of San Diego violated certain sections of its Charter, as well as related sections of the City of San Diego Municipal Code, by failing and refusing to contribute actuarially appropriate amounts to SDCERS. Specifically, the lawsuit alleges "[t]he funding method adopted by CERS [sic] and the individual defendants is not one of the six approved funding methods permitted under the rules set forth by the Governmental Accounting Standards Board." The allegations focus primarily on the City's alleged violation of the cited provisions of its Charter and Municipal Code by failing to contribute funds to SDCERS according to the terms of the '96 Agreement, and thereafter obtaining a greater reduction of its contribution obligation through the adoption of the '02 Proposal.

The lawsuit seeks declaratory relief in the form of a judgment that the City violated the terms of its Charter and relevant provisions of its Municipal Code, and that SDCERS' Board and the Individual Defendants breached fiduciary duties owed to the plaintiff class. The lawsuit also seeks restitution from the City of San Diego of all amounts owed to SDCERS as a result of past violations (an amount estimated in the hundreds of millions of dollars), injunctive relief prohibiting further unlawful underfunding, money damages for retirement benefits which would have been paid to the purported plaintiff class but for the alleged violations, money damages from the Individual Defendants for damages proximately caused by their alleged breach of fiduciary duty, and removal of the Individual Defendants from the Board of SDCERS.

E. SDCERS Proposed Response to the Complaint.

The complaint makes clear that both the Individual Defendants, as members of the SDCERS Board, acted in their official capacity when they entered into the Agreement which is the subject of the *Gleason* litigation. For this reason, we think

that both the Individual Defendants, and SDCERS, may be immune from liability for the conduct at issue in the complaint, pursuant to Government Code sections 820.2, 821, and 815.2, respectively. We are presently researching whether any exceptions exist to these immunity statutes based on the nature of the alleged misconduct. If no such exceptions exist, it may be appropriate to demur to the complaint.

Before making this decision, however, consideration should be given to whether it is in SDCERS' best interests to extricate itself from the litigation at this early stage. While this may seem on its face to be counterintuitive, the underlying reasoning is as follows. The plaintiffs' objective is primarily to obtain funds from the City, both in the form of past contributions which were "wrongfully withheld," and increased future contributions. To the extent the complaint could achieve this form of relief, SDCERS would benefit. If SDCERS were to extricate itself from the litigation at the pleading stage, it would lose its status as a party, and its ability to affect the outcome of the litigation, which likely will be accomplished through the mediation process. Of course, the litigation would proceed against the City; therefore, the potential benefit to SDCERS from a judgment in favor of the plaintiffs would not disappear should SDCERS successfully demur to the complaint. Nonetheless, as you are aware, not being present at the "mediation table" with the City can have serious adverse consequences for SDCERS.

By electing not to demur to the complaint, SDCERS would not lose its ability to raise the immunity statutes as a defense. Such statutes can be pleaded as affirmative defenses in an answer, and thereafter be used as the basis for a motion for summary judgment which could be filed in the event early mediation proved unsuccessful. We intend to discuss this strategic decision with you in further detail once you have had an opportunity to review this letter.

F. Post-Demurrer Litigation Analysis

While we believe a reasonable probability exists that this matter could be dismissed as to SDCERS at the pleading or summary judgment stage, it nonetheless is necessary to advise you of our opinions as they relate to issues likely to arise in the post-pleading phase, should the case advance that far.

In the event the Court concludes SDCERS is not immune from liability, it will be necessary to answer the complaint and proceed with discovery. At the time the answer is filed, however, consideration should be given to filing a cross-complaint

alleging conspiracy between the City and Unions to cause SDCERS' Board members to breach their fiduciary duties to its members and their beneficiaries. While this may seem antithetical to SDCERS' custom and practice in its dealings with the City, it highlights the significantly different circumstances forced on SDCERS by the filing of the *Gleason* litigation.

As we advised in the preceding section, SDCERS' interests arguably are aligned with plaintiffs' interests, at least to the extent that increased contributions by the City would benefit SDCERS. However, although SDCERS' interests are aligned with plaintiffs', its status as a defendant does not allow it to control the manner in which claims for such relief are prosecuted. For example, plaintiff counsel could settle with the City on the basis of ill-defined promises of future remedial action, combined with a large amount of attorney's fees for procuring such "relief." Under such circumstances, SDCERS would gain none of the advantage from the litigation to which it is arguably entitled. Filing a cross-complaint would confer standing on SDCERS to control the manner in which relief is sought, and potentially granted, rather than relying on plaintiffs to obtain all appropriate relief.

A cross-complaint against the City and Unions would be based on information that indicates certain union representatives obtained benefits for themselves and co-members of their union as part of the negotiation process over adoption of the modified '02 Manager's Proposal. If proven, this would support the conclusion that these individuals breached their fiduciary duty to SDCERS by approving a plan which included enhanced short-term benefits for themselves, while at the same time allowing the City to reduce its contribution to SDCERS.

Our recommendation in this regard also results in part from our conclusion that SDCERS Board members breached their fiduciary duty by executing the November 18, 2002 Agreement. As you are well aware, the California Constitution requires SDCERS Board members must discharge their duties for the exclusive purpose of providing benefits to participants and their beneficiaries, while also minimizing employer contributions and defraying reasonable expenses of administering the system. However, where these objectives conflict, the duty to participants and beneficiaries takes precedence over any other duty. Based on our analysis of the available information, we believe a trier of fact would conclude that the only party to the November 18 Agreement that obtained any benefit therefrom was the City, in the form of long-term contribution relief. All available actuarial analyses show SDCERS will receive substantially less money under any version of the '02 Manager's Proposal, when compared to the '96 proposal. Parenthetically,

we believe the justification for adopting the '02 Proposal based on avoiding "uncertainty" over the terms of the '96 Agreement is insufficient to justify adoption of the '02 Proposal. Regardless of which interpretation was applied to the '96 Agreement, if SDCERS stood to gain between $25 and $75 million based on what its actuary and fiduciary thought was a reasonable interpretation of the '96 Agreement, it is difficult to accept the proposition that an "advantage" was gained by agreeing to a proposal that not only abandoned the arguable right to a $25 to $75 million contribution, but locked in a significant reduction in contributions over the following 8 years.

In addition to agreeing to a reduction in the City's contributions, SDCERS Board members accepted the November 18 agreement knowing its acceptance was a prerequisite to the City's agreement to pay increased benefits to certain of its unions. Thus, the Board agreed to a proposal that not only increased the vested benefits for which it was or would become liable, but at the same time impaired SDCERS ability to meet those obligations by accepting a reduced contribution obligation by the City.

Further on this issue, there appears to have been only limited inquiry into the means by which the City would ramp up its contributions over the term of the November 18 Agreement to meet the "agreed" contribution rate by 2009. The record shows the City sought contribution relief because of the near-certainty that the 82.3% funding ratio trigger would be hit by June 2003. Moreover, the City provided further justification for the requested contribution relief in the form of statements to the effect that its revenue in 2004 would be even less than in 2003, by virtue of the State "raiding" the City's revenue sources to pay for its own budget deficit. As SDCERS' fiduciary advised it when the '96 Agreement was adopted, the Board members are held to the standard of a professional banker, and must evaluate the financial condition of the City, before agreeing to grant it what amounts to debt relief. Yet here, the City offered no information to support its contention that it would somehow be able to contribute more to SDCERS between 2005 and 2009 than it ever had in the past, and thus reach the actuarially calculated contribution rate by 2009.

We anticipate that regardless of whether SDCERS prevails at the pleading or dispositive motion stage, and thus is no longer a party to the litigation, the foregoing facts nonetheless will come out in discovery. Our review of the record leads us to conclude little, if any, evidence exists that Mr. Roeder provided the necessary actuarial support for the Board's adoption of the '02 Proposal. Our

interview with Mr. Roeder confirmed this conclusion. We anticipate that when plaintiffs depose Mr. Roeder, he will testify that the November 18 Agreement was not based on actuarially sound conclusions, and that it will result in substantially lower contributions by the City to SDCERS than would have resulted had the '96 Agreement remained effective.

We have not yet had an opportunity to interview Mr. Blum and Ms. Hiatt. Therefore, we have not been able to ascertain what substantive changes to the initial '02 Proposal convinced them to change their draft opinion, which stated adoption of the '02 Proposal would be a breach of SDCERS Board members' fiduciary duty, to their November 18 opinion, which appears to support the Board's decision. The absence of clear and specific facts supporting this turnabout leads us to conclude Mr. Blum's final opinion letter may be insufficient to protect SDCERS Board members from a finding that they breached their fiduciary duty.

Conclusion and Recommendations

The record we have reviewed clearly shows SDCERS was backed into a corner by the City, which agreed to provide enhanced benefits to its union members, and thereafter sought to "pay" for these benefits through reduction of its contributions to SDCERS. The City's enhanced benefits proposal to its unions was expressly contingent on SDCERS' agreement to reduction in the City's contributions. In essence, the City and unions forced SDCERS into precisely the circumstance its fiduciary counsel and actuary considered highly improper: linking benefit enhancement with contribution relief. Furthermore, the inherent and recognized conflict under which certain SDCERS Board members operate appears to have been exacerbated by the inclusion of additional benefits for those Board members during the negotiation process.

To avoid a continuation of this inherent conflict during our representation of SDCERS in the *Gleason* litigation, we recommend SDCERS form a litigation committee to direct its defense of this litigation. Our review of SDCERS' Charter indicates it cannot act without a quorum of its Board. In light of the fact the majority of its Board are Individual Defendants, and are separately represented, the composition of the litigation committee is a difficult question, and lacks clear precedent. Nonetheless, we believe the committee should be comprised of the Board president, at least one senior Staff member and Staff counsel, and Board members who have the fewest possible ties to either the City or the unions. This would allow a relatively "disinterested" litigation committee to make

recommendations to the Board on important decisions to be made in defending against the *Gleason* litigation. In this manner, the influence of "interested" (and potentially conflicted) parties would be at least minimized, thus increasing SDCERS' ability to defend this action in a manner consistent with its Constitutional mandate.

If the "litigation committee" format proves unworkable, SDCERS may be able to adopt a course of action similar to that used by corporations defending against derivative lawsuits in which a quorum of disinterested directors cannot be assembled. In such circumstances, the corporation will sometimes hire a "litigation representative" whom it empowers to act on its behalf in directing and controlling the litigation. We have not yet researched whether SDCERS' rules of governance would permit it to designate an independent third party as its litigation representative in this action, but would be happy to do so if you so choose. Potential candidates for such a position would include retired judges such as Hon. Lawrence Irving, or Hon. Howard Wiener, or other individuals with an outstanding reputation for ethical conduct and business judgment.

In light of our conclusion that SDCERS Board members breached their fiduciary duty to its members and their beneficiaries by executing the November 18 Agreement, we believe it should adopt a litigation strategy designed to obtain an increased contribution obligation from the City. The first step in this process would be to exercise its right under the November 18 Agreement to "nullify" the Agreement. Thereafter, SDCERS should work with its actuary to produce a defined contribution schedule which meets SDCERS' obligations to its members and their beneficiaries in a manner consistent with other public agencies in this State. This actuarial calculation should then be used as the basis to obtain a new contribution agreement from the City in the context of mediation proceedings in this litigation.

We believe mediation is appropriate in this matter both because it would avoid a finding that SDCERS Board members breached their fiduciary duty to its members, as well as because we believe this will not be the last lawsuit Mr. Conger files as a result of the November 18 Agreement. As members of Staff have made clear to us, SDCERS has sufficient funds to meet its current obligations to the class of retirees. What Mr. Conger appears to not yet appreciate is that the November 18 Agreement compromised the interests of *future* SDCERS members much more than those of *existing* members. That is, from Mr. Conger's perspective, he has the "right" lawsuit, but the wrong plaintiff class. We suspect this fact will not be lost on Mr.

Conger forever. In the meantime, the defendants enjoy a small strategic advantage in developing a strategy that would eliminate the potential for a second lawsuit on these facts while plaintiff counsel remains apparently unaware of the possibility of such a lawsuit. Developing a litigation strategy, as outlined above, that incentivizes the City to cooperate in reaching that goal is therefore of paramount importance.

As everyone is well aware, this is an extremely complicated matter, with ramifications reaching far beyond the limited scope of the *Gleason* litigation itself. We recognize that our analysis and recommendations may be inconsistent with SDCERS' political objectives, and we cannot offer any guidance on how to reconcile the two. Nonetheless, having been forced into litigation over what was originally a political and legislative issue, SDCERS must now formulate a litigation-based strategy for dealing with its current circumstances. After reviewing this letter, we would appreciate an opportunity to meet with appropriate SDCERS representatives to discuss this issue further.

Thank you for your attention to this matter. We look forward to hearing from you.

Very truly yours,

Reg A. Vitek
Seltzer Caplan McMahon Vitek
A Law Corporation

MAL/RAV:bs
cc: Michael A. Leone, Esq.

P:\7\7835\56570\Corres\LET Leone re litig eval.doc

EXHIBIT NO. 29

From: leone
Sent: Friday, March 07, 2003 8:51 AM
To: "'sleone@sandiego.gov'" <sleone@sandiego.gov>
Cc: "Vitek; Reg" <vitek@scmv.com>; "Saler; Beth" <Saler@scmv.com>
Subject: Gleason Update
Attachments: Mime.822

Sheila:

I spoke to Mike Conger, who agreed we should all go in an see Judge Hayes on the 11th to discuss conflict issues and agreed on a deadline for resolving them and getting responsive pleadings on file. He said he will not attempt to take a default against SDCERS in the meantime. I will forward you a copy of all party's ex parte papers later today.

Conger advised he intends to move for summary adjudication of his first cause of action against the City as soon as possible. He appears focused on the idea that the City's charter precluded it from seeking the forms of contribution relief it sought in both '96 and '02. He said that regardless of whether he gets a hearing date at the ex parte next Tuesday, he will serve everyone with his papers because he wants us all to know how strong he feels his position is on the basic issue framed by his pleadings. My sense is he is taking a very academic, statutebased, approach to this case, and does not yet realize the "tort potential" of this case. I think that will change once he starts deposing Board members and witnesses.

Conger also advised that he does not feel his position is entirely adversarial to ours in the sense that recovery of money from the City benefits SDCERS. I told him I agreed with him in principle, but because we do not yet have a person or committee to direct us in this litigation, I could not make any representations regarding our litigation strategy.

Conger also told me what he wants is for the Board to exercise the "nullification" clause in the November 18, 2002 Agreement. While I made no responsive comment, I told him it was clear to us his primary target is the City.

Finally, Conger mentioned that he has videotape of at least the November 15 hearing, if not all of them. Is there any way we can get our hands on copies of such videotapes?

We will update you after the hearing on Tuesday. In the meantime, if you have any questions or comments, please feel free to contact me.

Regards,

Mike Leone
Seltzer Caplan McMahon Vitek
2100 Symphony Towers
750 B Street

3/11/2005

EXHIBIT NO. 30

From: Sheila Leone
Sent: Monday, March 24, 2003 1:14 PM
To: LChapin
Cc: RParks
Subject: Blum Meeting. Do Not Forward

Lori,

The meeting with Connie and Bob was notable for many reasons (not all of which are discussed here) but nothing is more shocking than Connie and Bob's individual statements that Larry called each of them and told them SCMV was looking to sue them for malpractice. Needless to say, his call was damaging to the System because it made Connie and Bob much more careful. I am simply at my wits end. How many ways can I say, "don't discuss this" with anyone? Reg feels Larry is "playing both sides of the fence" and is concerned. I don't have "client control" so perhaps Reg should meet privately with Larry. I cannot understand why Larry did this. It's a real betrayal of the System.

Bob was shown Ron's "presidential leave" benefit. He called it "absolutely breathtaking", said he had no knowledge of it and concluded the existence of the benefit could invalidate the entire manager's proposal. This, obviously, is huge.

Bob was apparently very candid that approval of the benefits was "absolutely tied" to the Board's vote on the manager's proposal. He said that his June letter (against the deal) was written because Larry told him to "kill the Manager's Proposal." For whatever reason, Larry changed his mind. Then, according to Blum, there was enormous pressure to "make it happen."

Blum contends he wrote Roeder's letter at Larry's insistence (frankly disturbing). Blum's opinion changed because it's what Larry wanted - not- by the way a solid legal defense.

Mike will tell me more tomorrow.

On the BOard meeting, Reg thought it was terrible. He was really surprised by Ray Garnica's behavior. In any event, after the meeting Larry told him "there's a lot more side deals" than that concocted by Ron. Reg was adamant - he needs to know what Larry is talking about. Will get dates for another meeting tomorrow.

I have to say, we are miserable clients. We are not only ignoring advice, we have taken active steps to damage our client's position.Thanks Sheila

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EXHIBIT NO. 31

From: LGrissom
Sent: Wednesday, March 12, 2003 4:37 PM
To: Sheila Leone
Cc: LORI CHAPIN; Roxanne Story Parks
Subject: Gleason/Diann
Attachments: TEXT.htm

Shelia
Apprieciate it if you would run this by Seltzer. Have it on good authority that Diann has been invited to speak to the Board of Directors of the Retired Employees Association. This is obviously at the insistence of Dave Wood. If one assumes that Wood is looking for a "friendly" on the Board, or to gain info that will help their cause, either one of which is reasonable to me, I have a question as to whether or not this could constitute a conflict. Second issue, raised by Fred, is whether or not he, or Seltzer should/could impose a gag order on the Board not to discuss the litigation with anyone, including to offer opinions. If you think this is inappropriate to ask, let me know.

Larry

EXHIBIT NO. 32

From: Lawrence Grissom
Sent: Friday, March 14, 2003 9:06 AM
To: SLeone
Subject: Re: Seltzer Billing

Sheliathanks. I agree, we need to work something out. Is Seltzer's concern that if we present detail to the Auditor to support payment we will somehow be creating a conflict situation due to Terri's position on the Board? If that is the case aren't we being way too inflexible? Seems like a genuine catch 22. Auditor won't pay bill without detail. We can't control costs without detail. Seltzer won't supply detail unless we guarantee non disclosure. Everybody loses.

Sorry to ramble. Guess what I need from you is a risk assessment.
Larry

>>> Sheila Leone 03/13/03 05:42PM >>>
Redacting means "blacking out" any privileged information in the bill, such as research re: strategy or advice. So, the bill might read " research re: _____. 2.0 hours If we don't redact, we will get much less detailed billing which in the long run is not good for us. In any event, we need to work something out. Sheila

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>>> Lawrence Grissom 03/13/03 05:14PM >>>
you win word a day. What is redacting?? I think we should deal with the issue up front. Auditor's staff has marching orders to go over everything with a fine tooth comb in "these troubled times" and a demand for detail to back up billing is fairly certain.

Larry

>>> Sheila Leone 03/13/03 05:00PM >>>
Larry and Lori, Reg just asked an interesting question. He wanted to make sure the "detail" of their bill is not being provided to the Auditor. There is a summary page, which includes no references such as "research re lawsuit against City".....Can we get them paid without the detail. If we cannot, we are going to need to have someone devoted to redacting their bills. Let me know. Sheila

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EXHIBIT NO. 33

THE CITY OF SAN DIEGO

March 26, 2003

Mr. Larry Grissom
Administrator
San Diego City Employees Retirement System
401 B Street, Suite 400
San Diego, CA 92101

Dear Larry:

At the Board meeting last Friday, our outside counsel, Reg Viteck from Seltzer Caplan, recommended the Board appoint a sub committee of non-defendants to make decisions and give counsel direction in the pending litigation. Alternatively, he recommended an independent outside party be appointed to fill the same roll. This was in light of the obvious conflict of interest by defendant Trustees who might be unable to make litigation decisions in the best interests of the System in conflict with their individual legal exposure in the litigation.

In response to my inquiry, Mr. Viteck also recommended that the back-loading agreement approved by the System last November 15, and by the City Council on the 18th, be revoked, as we are able to do under that agreement.

I moved the board appoint the non-defendant sub committee. I also moved the second recommendation by Mr. Viteck that the back-loading agreement be revoked.

The Board voted to keep the litigation decision making with the whole board, and my second motion to revoke the back-loading agreement failed for lack of a second.

This behavior is exactly the type Mr. Viteck was concerned about when recommending that the defendant Board members be disqualified from acting on these issues.

I request that the Board obtain separate outside counsel to advise whether the Board can make the decisions referenced above in light of the conflicts of the defendant members of the board.

Sincerely,

Diann Shipione

Diann Shipione
Trustee

City Employees' Retirement System
401 B Street, Suite 400, MS 840 • San Diego, CA 92101-4296
Tel (619) 533-4660 Fax (619) 533-4611 or 533-4629

EXHIBIT NO. 34

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GERALD L. MCMAHON
REGINALD A. VITEK
STEPHEN DOUGLAS ROTER
DAVID J. DOANE
JAMES R. DAWE
BRIAN T. SELTZER
ELIZABETH A. SMITH
JOYCE A. MCCOY
DENNIS J. WICKHAM
JOHN H. ALSPAUGH
JAMES P. DELPHEY
ELINOR T. MERIDETH
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THOMAS F. STEINKE
NEAL P. PARISH
SEAN T. HARGADEN
DAVID S. MINTON
DAVID J. ZUBKOFF
CHARLES L. GOLDBERG
PATRICK O. HALL
MICHAEL A. LEONE
DANIEL A. ANDRISI
J. SCOTT SCHEPER
LEE E. HEJDANOWSKI
DANIEL E. EATON
N. CHRISTINE TENNISON
ANDREW D. BROOKS
PAUL R. DATNOW
JOHN M. TOSCANO*
MARNIE S. SKEEN
DAVID M. GREELEY
TROY A. KINGSHAVEN
CHARLES B. WITHAM
RHONDA K. CRANDALL
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SELTZER | CAPLAN | McMAHON | VITEK

A LAW CORPORATION

April 2, 2003

Lawrence B. Grissom, Retirement Administrator
Loraine E. Chapin, Esq., General Counsel
San Diego City Employee's Retirement System
401 B Street, Suite 400
San Diego, CA 92101

Re: James F. Gleason, et al. v. San Diego City Employees' Retirement System, et al.
San Diego Superior Court Case No. GIC 803779
Our File No. 07835.56570

Dear Ms. Chapin and Mr. Grissom:

The purpose of this letter is to memorialize the San Diego City Employee Retirement System's ("SDCERS") decision, made on Tuesday, April 1, 2003, during my conference telephone call with Larry Grissom, Paul Barnett and Fred Pierce, to accept this firm's withdrawal from further representation of SDCERS in the above-referenced litigation. As we discussed yesterday, the factors that require our withdrawal are as follows:

In our initial evaluation, dated March 5, 2003, we concluded the individual defendants in the action had breached their fiduciary duty by adopting the 2002 City Manager's Proposal ('02 Manager's Proposal), which is the subject of the *Gleason* litigation, and had subordinated SDCERS' (our client's) interests to the interests of themselves, their unions, and the City. Accordingly, we recommended SDCERS form a litigation committee to direct its defense of the *Gleason* litigation to avoid continuation of the inherent conflicts of interests. Since our initial evaluation, our investigation has revealed additional evidence which supports our March 5 conclusions concerning the conflicts involved; however, no information has come to light which was inconsistent with our conclusions in that regard.

During an executive session on March 21, 2003, we were asked to, and did, present our recommendation of an independent litigation committee/person to the Board. All but one of the individual defendants were present and participated. Our recommendation was resoundingly rejected. Not surprisingly, much of the opposition came from those individual defendants who were most conflicted in the deliberations over the '02 Manager's Proposal. Following the March 21 executive

session, we met with Larry Grissom and it was decided we would attempt to revisit the issue with the Board, and to supplement our earlier recommendation with an opinion from fiduciary counsel to the effect that delegation to a disinterested person of responsibility to deal with the litigation would be proper under the Board's applicable rules of governance.

We provided Bob Blum with a copy (which he did not have) of Rule 1.40 of the Rules of the Retirement Board, because we felt it was pertinent to the issue at hand. We were then advised, by Bob Blum, that he and Connie Hiatt had concluded the Board "can and should" appoint some neutral person or persons to act in that capacity. In fact, Mr. Blum even recommended an acquaintance of his (Ellen A. Hennessy) as a candidate for that position.

We had intended to appear at another executive session of the Board on Wednesday, April 2, 2003, to revisit the matter of our advice that an independent committee or person be appointed to direct our firm in the handling of the *Gleason* litigation. Wednesday afternoon, just before the conference call, Larry Grissom informed me the Board remains adamantly opposed to appointing anyone as an independent litigation representative, and that the executive session should probably be cancelled. I reiterated what I had said to him the preceding week – that, absent appointment of some independent committee or person from whom we can take direction, we see no ethical alternative to our withdrawing as counsel for SDCERS. At Larry Grissom's request, I repeated that conclusion during the conference call with him and Messrs. Barnett and Pierce.

We genuinely regret we are unable to continue in the representation of SDCERS; however, we feel it would be professionally irresponsible for us to do so under circumstances where we would be taking direction in this very serious litigation from individual defendants who not only have demonstrated a willingness to subordinate SDCERS' interests to the interests of other persons or entities (including themselves), but who, in addition, have conflicts of interests created by the litigation itself.

As I mentioned during the conference call, we will do everything within our power to make the transition to replacement counsel as smooth as possible. In that regard, I have since learned the Superior Court has signed the order we requested extending the time in which to file responsive pleadings from April 9 to April 29.

Additionally, plaintiff counsel has agreed to an extension of time to the same date for SDCERS to respond to outstanding discovery.

We appreciate the opportunity to have represented SDCERS, albeit for a very short period. We regret circumstances exist that, in our professional judgment, require us to withdraw. Please advise us when you have selected replacement counsel, as there are several open issues presented by recent communications from Mr. Conger.

Very truly yours,

Reg A. Vitek
Seltzer Caplan McMahon Vitek
A Law Corporation

RAV:bs
cc: Roxanne Parks, Esq.
Sheila Leone, Esq.

EXHIBIT NO. 35

From: LChapin
Sent: Tuesday, April 08, 2003 6:20 PM
To: Roxanne Story Parks; Sheila Leone
Subject: Trustee ad litem (TAL)

Rej,

We had a conference call with Bob and Connie this afternoon. Paul and Larry participated. We wanted to get a feel for Bob and Connie's strength of position regarding the "independent trustee" concept. In essence, as I heard them, they felt the Board could delegate the handling of this case to a third party, if they the Board really felt they could not handle, but if they felt they could handle they did not have to do so. This was hardly the strong support I thought I heard they expressed on earlier occasions. After a fair amount of discussion, they came back to, the Board really should delegate to a third party. They felt they could really get behind this approach. The discussion then shifted to how best to accomplish this.

This led to a discussion of the concept of a Trustee ad litem (TAL) initially suggested by David Hopkins. Under this approach, they felt our office should petition the court for a ruling on the need to appoint a TAL. In essence, the Board would not admit any wrong doing. Instead, the petition would note the appearance of a conflict, the withdrawal of our outside counsel, the fact we have solicited others who share the views of outside counsel and the absolute need to move forward on the basic defense. Included would be a request for a ruling on the need to appoint a TAL. They (Bob & Connie) felt this would insulate both Rej and the Board from future beneficiary generated suits based on representation of a conflicted board. I tend to agree but have several reservations.

For example, right now the issue of who would be the TAL is not resolved. We don't want the court to appoint. I am concerned that if we don't have someone in mind to suggest to the court, the court may decide to pick one for us.

I want to talk this over with you before calling Rej. I also may need to hear more from David Hopkins on the TAL concept.

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EXHIBIT NO. 36

From: David Hopkins
To: Webster, Terri
Date: 4/17/03 5:35PM
Subject: Re: Gleason Case Update and 4/18 meeting agenda

ATTORNEY-CLIENT PRIVILEGED COMMUNICATION

Terri:

Thank you. I had forgotten that interchange at the closed session. It was not that significant to me because, at the time, there was no doubt in my mind that the proposal before the Board was to grant a complete delegation of authority, including the authority to settle. If all that was being requested was that someone other than in-house counsel be appointed to manage the day to day details of this case, that would have been a simple proposal.

I don't think any confirmation as to what was said at the meeting will be needed at this point. But, just as a matter of inquiry, are you sure that the closed sessions are taped or typed?

I am now advised that only day to day management is at issue, and further advised that there are good reasons that that function should not be fulfilled by your in-house counsel. Thus, the issue on the table now is for a more limited delegation. Provided the limitations are real (see the final paragraph below) I believe it would not be contrary to the interests of the individual board members to make a limited delegation to an agent to manage the litigation. Sorry for the double negative. Phrased the other way, I believe it would be contrary to the individual interests of the Board members to make a delegation that is unlimited and unsupervised.

If the delegation is unlimited and unsupervised there is the possible legal risk that the individual board members could lose their immunity. There is also a possible "PR" risk. It could be argued that, if you can delegate this decision you should also have delegated the decision whether to adopt the manager's proposal. To minimize those risks the delegation must be both supervised and limited.

In my opinion the delegation must expressly include the following, at least.

1. The Board's express retention of the power to direct the litigation, including the power to agree to and craft any settlement terms (that is, the Board's power should not be limited to approval/veto of what is put before it by the special litigation committee or person or trial counsel).

2. An express requirement that the delegee report on a specific regular interval (and more frequently if needed) to the Board on the status of the case and to take any direction the Board wishes to give.

3. An express requirement that the delegee be qualified. The necessary requirements will depend on the scope of the delegation. For example, if the delegation is merely for the day to day management of the litigation, the delegee could be a litigation attorney with, say, 5 years experience. If, on the other hand, the delegee is to advise the Board with respect to substantive issues related to the merits of the lawsuit, the person should be well versed in pension management and public trust issues.

Although the ultimate decisions must always remain yours (IE, whether or not to follow the advice of the delegee), the greater the responsibility and experience the delegee has, the greater the potential fallout to the individual Board members personally for failing to follow the delegee's advice. That leads to a fourth proviso:

4. An express assurance from the delegee and from the person who suggests the delegee that all communications between the delegee and the Board will remain confidential and, even better, subject to a legal privilege. In that regard it would be best if the delegee were a licensed attorney. (The attorney client privilege also extends to a non-lawyer who is essential for the representation.)

One final concern. The history of this issue, including the initial request that the delegation be unlimited, the resignation of counsel when the Board rejected that request, and counsel's express reservation of the right to resign if future advice of counsel and/or the special litigation committee is ignored, raises doubts whether the delegation will be truly limited despite the express language of the delegation. The history, in my view, carries with it a certain element of at least implied duress. If, in the future, the advice of counsel or the delegee were to be ignored again, and counsel and/or the special litigation consultant withdrew or was fired, there would be significant political and public relations ramifications, at least.

I look forward to meeting with you tomorrow.

David B. Hopkins, Esq.
Hillyer & Irwin
550 West C Street, Suite 1600
San Diego, California 92101
phone (619) 595-1269
fax (619) 595-1313
e-mail dhopkins@hillyer-irwin.com

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IF YOU HAVE RECEIVED THE EMAIL IN ERROR, PLEASE REPLY TO THE SENDER IMMEDIATELY AND INFORM US OF THE ERROR. THANK YOU.

>>> "Terri Webster" <TWebster@sandiego.gov> 04/17/03 03:08PM >>>
David

In regards to pages 3 and 4 of your Lori letter:

I recall that I asked Vitek in closed session if this third party person would be resposible for everything including determining settlement and he reponded "yes". Since Sally Zumalt was there either taping or typing the meeting I believe that can be confirmed if needed.

Page 4...footnote 3 on Probate Code 16012 is great:. you would think Conger would definitely be opposed to Ed Ryan and Mike U. delegating the case to a third party outsider if he is opposed to them delegating the case and other retirement duties to their top managment employees!

Terri

CC: clexin@sandiego.gov; dvortman@nassco.com; fpierce@foundation.sdsu.edu;

jcasey@sandiego.gov; jttorres@msn.com; Lexin, Cathy; mvattimo@sandiego.gov; pbnuggets@aol.com; rg92129@hotmail.com; rsaathoff@aol.com; swilkinson@sandiego.gov; Vattimo, Mary

EXHIBIT NO. 37

From: dvortman
Sent: Monday, April 21, 2003 12:37 PM
To: "Fred Pierce" <Fpierce@foundation.sdsu.edu>
Cc: john torres; " <jttorres@msn.com>; <Mvattimo@sandiego.gov>; <Rsaathoff@sandiego.gov>; <LGrissom@sandiego.gov>; <Szumalt@sandiego.gov>
Subject: Re: Litigation Representative

Fred
Just a thought to consider: while the need to get someone in place and up to speed as quickly as possible to support the time needs of this litigation, we must balance that with the need for appropriate "due diligence", as fiduciaries, in making this critical decision and selection (and we need to make sure the record clearly demonstrates this due diligence)
Dick

Fred Pierce wrote:

> Per the board's direction on Friday, we will be convening the
> Executive Committee ASAP to review those individuals who have been
> recommended to serve as our Litigation Representative in the Gleason
> matter. Mr. Grissom will be e-mailing resumes of the recommended
> candidates later today. Please review these resumes prior to the
> meeting. If you all concur, I am suggesting that we arrange a meeting
> as soon as mutually agreeable for the Executive Committee to get
> together with Reg Vitek, Bob Blum (likely via teleconference) and
> selected staff. We will have the recommending source (so far either
> Reg or Bob) provide editorial comment on the respective candidates
> they have recommended, which will augment the written resume. Based
> upon the written and verbal information, I anticipate the Executive
> Committee and staff will discuss the candidates and the Executive
> Committee will make a selection. Given the timing, I am hoping to be
> able to make a selection without having to do candidate interviews,
> which would lengthen the selection process by several hours and may be
> very difficult to schedule given short notice and our respective
> schedules. Of course, if we cannot come to a decision based upon the
> written and verbal information, we could subsequently set up
> interviews if necessary. I am hopeful this won't be necessary. Sally
> will be contacting you to determine your availability for this
> meeting. Thanks. Fred. Frederick W. Pierce, IVPresidentThe Pierce
> Company, Inc.5250 Campanile Drive, 4th FloorSan Diego, CA
> 92182-1940(619) 594-5762(619) 594-2318
> faxfpierce@foundation.sdsu.eduReal Estate Developers for Education

EXHIBIT NO. 38

From: LGrissom
Sent: Thursday, April 24, 2003 12:57 PM
To: Fred Pierce
Cc: Loraine Chapin; Paul Barnett
Subject: litigation consultant
Attachments: TEXT.htm

Fred
Reg Vitek has made contact with Nell Hennessey and she has accepted the assignment. He was quite impressed with her. She will be in San Diego on May 1215 and we are attempting to see if she can stay over to meet the Board at our regular meeting on May 16.

Larry

EXHIBIT NO. 39

C

Leone, Michael

From: Lawrence Grissom [LGrissom@sandiego.gov]
Sent: Friday, September 12, 2003 2:47 PM
To: leone@scmv.com
Cc: Loraine Chapin; Paul Barnett; Sheila Jacobs
Subject: Justificatin

File SDC 025 I

Mike
I think it was on Sept 10, you sent an e-mail looking for info on one of Conger's interrogatories, and I promised a response. The question was basically, what is your justification for approving the City deliberate, illegal, immoral, fattening and otherwise bad underfunding since 1997.

First thing is that justification is a loaded word. All the psychobabblers tell you not to use this word when discussing your sins with your mother, wife, or girlfriend. The dialog with Conger would go something like:
This is my justification.....
Not good enough. You are wrong. Give me money.

Therefore, a formal response could go something like -- The Board considered a request from the City and approved that request only after a lenghthy deliberation which invovled input from fiduciary counsel, actuary and other advisors and was conducted in a public setting. Please refer to the 2,500 pages of relevant documents previously provided.

For you and you only, I could write a treatise, but will attempt to excercise some degree of parsimony.
In the perfect world, you have an annual actuarial valuation which recommends employer and employee contribution rates. The Board duly considers said valuation, passes it and refers it to the plan sponsor who pays those contribution rates. Benefits are enhanced, the actuary prices them, recommends contribution rates. The plan sponsor and employees pay those rates. And guys like me administer all of those benefits and all that money.
The real world is different, dramatically so in the last 10 to 15 years. Governmental budgeting processes dislike spending any money for anything not visibly for the "public good". I think, for instance, that a City Council would rather add police officers than increase the salary of existing force. Since the pie is just so large, and there is never enough money to cover everything, there is always stress on how to divide e.
In the standpoint of contributions to the System, one of those stresses comes from the combination of timing and volatility. We are on a July fiscal year. In a good year, we will receive the actuarial valuation in November or December and pass it in January or February. By that time the annual pagan exercise known as budget preparation is 40% to 60% compete. Volatility in terms of actuarial gains or losses that cause even a $5 million increase or decrease to "pension costs" can be traumatic, and the trauma increases exponentially with the size of the dollar change. Therefore, government seeks stability and predictability for this expense.
This was the basis on which MP I was sold. It also used the Claypool analysis, wherein the Supreme Court of our great state said that it was ok under the constitution to grant contribution relief in some form to the employer as long as there were offsetting benefits to the employees and other stakeholders. The then City Manager, Jack McGrory, was very smooth and did a very good to excellent of presenting and selling the concept. He did his homework well.
In my personal opinion, MP I was not a bad deal. City got a predictable contribution cost. Employees got a nice package of benefits. System got a steadily increasing stream of contribution dollars and downside protection. There's a lot of stuff here that was of concern to me at the time about being 100% funded, which is better saved for another term paper.
Subsequently, bad things began to happen. Both labor and management adopted an attitude of not caring about the costs of benefits, because the liability "can just be rolled into the Manager's Proposal". Greed happened. Long discussion about too many labor and management reps on retirement Boards generally -- that would be term paper #3.
Manager's Proposal II was not handled nearly as well as was the first one. The City's position was to say, new benefits, which we will pay for, but we see the train coming down the track and we need to shore up our downside protection (reduce floor). Their approach was if I give you this, you gotta give me that - carried out in a pretty roughshod matter. See term paper #3.
I'll stop the archaeology at this point. It is simply to bolster my perspective that there was very little justification to MP II even though we went through the same process as the first time. I don't blame the City for being scared about what might happen when we fell thru the floor. Had there been no MP II, we would probably be in litigation with the City over interpretation of MP I, and Gleason would likely be out there, albeit with perhaps less publicity. It still galls me that the beneficiaries whom we have all taken the holy oath to protect didn't give a damn about anything but their benefit enhancements.
Mike, I know I have rambled a bit and been a bit redundant. If this is not what your are looking for, lets dicuss when we talk next week.
Larry

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EXHIBIT NO. 40

From: Roxanne Story Parks
Sent: Tuesday, January 13, 2004 12:08 PM
To: SJacobs
Subject: Re: Interesting.

The benefits, or the funding agreement?? I know she was the architect of the benefits, along with other Board members (Ron and Terri)

>>> Sheila Jacobs 01/13/04 12:57 PM >>>
Roxanne, (Do not share this with anyone.) Cathy Lexin is going to be deposed soon. She is going to testify that she essentially wrote MPII.

EXHIBIT NO. 41

e.
56570

Leone, Michael

From: Vitek, Reg
Sent: Thursday, January 29, 2004 4:58 PM
To: Leone, Michael
Cc: Sheila Jacobs (E-mail)
Subject: Hanson Bridgett depositions

File

Here are some significant things that came out in the Blumm and Hiatt depositions:

1. At the time of the 7/11 meeting, as well as 9/20/02 (Exh. 63) Blumm had not yet reached an opinion on the Saathoff proposed amendment to the 2002 Manager's Proposal.

2. Blumm's 11/18 signed opinion omits 47 facts (re negative financial impact of MP2) which were included in the 6/12/02 draft opinion. (Neither Blumm nor Hiatt had any recollection why they were omitted.)

3. The 11/18 opinion omits Foonote 1 of the 6/12/02 draft which says that, if the trigger is hit, the City would have to infuse $75 million.

4. Neither Blumm nor Hiatt remember if they looked at the Charter or Section 1090 in connection with the opinions.

5. Blumm recalls that the nullification provisions was requested by the Board.

Reg A. Vitek

Seltzer | Caplan | McMahon | Vitek A LAW CORPORATION
2100 SYMPHONY TOWERS 750 B STREET SAN DIEGO, CALIFORNIA 92101
vitek@scmv.com 619.685.3075 619.702.6804 FAX

EXHIBIT NO. 42

From: Sheila Jacobs
Sent: Thursday, January 29, 2004 6:29 PM
To: vitek
Subject: Re: Hanson Bridgett depositions

Reg, Thank you. This really is not surprising. I have mentioned to Mike and I would like to ask you to recommend the Board sue them for malpractice. Unless it comes from your firm "e.g. real lawyers" nothing will come of this. I do not mean to be "bitter" on this subject, but I have many letters to Hanson Bridgett regarding billing for nothing and everyone ignored it. I was present at the meetings in which Bob Blum told the Board "all was fine" if they

"thought really hard." I also know he was assigned to work with the City Attorney to come up with something that would sell to the Board on MPII. Not once did he ever suggest that was contrary to his ethical duties. Roxanne and I were pretty much shocked. Sheila

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>>> "Vitek, Reg" <vitek@scmv.com> 01/29/04 16:58 PM >>>
Here are some significant things that came out in the Blumm and Hiatt depositions:

1. At the time of the 7/11 meeting, as well as 9/20/02 (Exh. 63) Blumm had not yet reached an opinion on the Saathoff proposed amendment to the 2002 Manager's Proposal.

2. Blumm's 11/18 signed opinion omits 47 facts (re negative financial impact of MP2) which were included in the 6/12/02 draft opinion. (Neither Blumm nor Hiatt had any recollection why they were omitted.)

3. The 11/18 opinion omits Foonote 1 of the 6/12/02 draft which says that, if the trigger is hit, the City would have to infuse $75 million.

4. Neither Blumm nor Hiatt remember if they looked at the Charter or Section 1090 in connection with the opinions.

5. Blumm recalls that the nullification provisions was requested by the Board.

Reg A. Vitek

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vitek@scmv.com 619.685.3075 619.702.6804 FAX

EXHIBIT NO. 43

From: Roxanne Story Parks
Sent: Friday, January 30, 2004 3:38 PM
To: SJacobs
Subject: Re: Fwd: FW: Blum Rough Ascii

What a flippin' weasel!!! His depo gives me a stomach ache especially the part about not having or recalling any opinion on what would happen under MPI if we crashed through the floor, which we did .....

>>> Sheila Jacobs 01/30/04 10:56 AM >>>
happy reading. please don't circulate

>>> "Vitek, Reg" <vitek@scmv.com> 01/30/04 08:38AM >>>
Sheila:
FYI, here is the rough of Bob Blumm's depo. Truly incredible.

Reg A. Vitek

Seltzer|Caplan|McMahon|Vitek A LAW CORPORATION
2100 SYMPHONY TOWERS 750 B STREET SAN DIEGO, CALIFORNIA 92101
vitek@scmv.com 619.685.3075 619.702.6804 FAX

Original Message
From: Depo4u@aol.com [mailto:Depo4u@aol.com]
Sent: Friday, January 30, 2004 6:46 AM
To: vitek@scmv.com
Cc: sf_litsupport@legalink.com
Subject: Blum Rough Ascii

Hi,

Here's the rough ASCII you requested of Mr. Blum's deposition. It was a pleasure working with you.

Carol Drobny

EXHIBIT No. 44

56570

Leone, Michael

From: Vitek, Reg
Sent: Monday, February 16, 2004 9:01 AM
To: Leone, Michael
Subject: FW: Blum

Let's discuss this today

Reg A. Vitek

Seltzer|Caplan|McMahon|Vitek A LAW CORPORATION
2100 SYMPHONY TOWERS 750 B STREET SAN DIEGO, CALIFORNIA 92101
vitek@scmv.com 619.685.3075 619.702.6804 FAX

-----Original Message-----
From: Sheila Jacobs [mailto:SJacobs@sandiego.gov]
Sent: Monday, February 16, 2004 9:00 AM
To: leone@scmv.com; vitek@scmv.com
Cc: Roxanne Story Parks
Subject: Blum

Reg and Mike: Do you plan to mention that the Board may want to consult a malpractice attorney this month? I am asking because although I sent an email to Larry, Paul and Lori after Blum's depo telling them not to continue to use Blum for advice, Larry is still calling him and getting "draft" email opinions. I think he may be damaging the Board's claim. Do you agree and if so, is it important to tell the Board sooner rather than later and also to tell them we should not be using Blum?? Larry may be doing this deliberately because he does not want to sue Blum. Sheila

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EXHIBIT No. 45

I 1.2.12

Memorandum

333 Market Street, Suite 2300, San Francisco, CA 94105-2173
Tele: (415) 777-3200, Facsimile: (415) 541-9366

HANSON BRIDGETT MARCUS VLAHOS RUDY LLP

TO: RAB

FROM: MNC

DATE: February 20, 2004

RE: **San Diego City Employees Retirement System--Analysis of Conflict of Interest Issue**

You have asked me to examine whether the approval of an agreement between the City of San Diego and its Retirement System may have resulted in a violation of Government Code Section 1090, which prohibits public officials from having a private interest in the contracts they participate in making[1] or which are made by a board or body of which they are members.

I. Background

Article IX of the San Diego City Charter provides for the establishment of a "City Employees' Retirement System" (System). Section 144 of the Charter provides for a "Board of Administration" (Board) to manage the System. The Board consists of the City Manager, City Auditor and Comptroller, City Treasurer, three members of the System (elected by the membership), one retired member of the System (elected by the retired membership), an officer of a local bank and three other citizens of the City. As a result, seven of the eleven members are presumably persons who are either current or prospective recipients of benefits of the System and may therefore (to the extent the decisions affect benefits or the ability of the system to pay them) have a financial interest in contract made by the Board. In addition, six of the eleven members are employees of the City, and thus have a financial interest as a result of the salary and benefits they receive from City, which may be relevant in any contracts they might approve with the City. Nevertheless, the City Charter provides for these individuals to make significant financial decisions for the System, including arrangements with the City for the transfer of funds necessary for the funding of the benefits the System is to provide.

In 2002, as a result of negotiations with labor unions representing City employees, the City entered into union agreement(s) providing for certain increases in benefits to its employees. Following the tentative approval of those agreements and in order to implement the increased benefits incorporated within them, the City sought to modify certain arrangement(s) it had with

[1] Section 1090 reads in 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 System. As a result, the City and the System entered into an agreement that changed the terms of a prior agreement re contributions to the System.

II. Legal Analysis

A. Government Code 1090

Section 1090[2] of the Government Code provides that no officer or employee of a public agency may have a financial interest in a contract "made" by them in their official capacity, or by any body or board of which they are a member. Included in this prohibition is almost any aspect of participation in the formation of the contract, including influencing the development of the contract. In addition, a member of a legislative board or body is conclusively presumed to have such an interest in any contract approved by that body, even if the member has disqualified his or herself from participation in that action.

1. Elements of a Section 1090 Violation

The elements of a violation of Section 1090 consist of: (1) a contract; (2) which is developed or negotiated by persons subject to the statute, or approved by a body or board of which they are a member; (3) when such persons have a financial interest in the contract. There are two categories of exemptions to Section 1090, consisting of "remote interests" (which are defined in Section 1091 and require disclosure and non-participation by the individual with the interest) and "non-interests" (which are defined in Section 1091.5 and generally do not require either disclosure or non-participation.) We will look at each of these elements of a violation with regard to the Board's approval of the agreement with the City, then consider the various exemptions.

a. Contract

A required element of a 1090 violation is that a contract have been entered into by a public agency. (Other statutes, such as the Political Reform Act (Gov't. Code §§ 81000 et seq.) address conflicts of interests in a wider range of governmental decision-making actions.) It is clear that a formal arrangement was entered into between the City and the System. However, in order to determine if this arrangement is indeed a "contract," we must look at the exact nature of the relationship between the City and the System and the terms of the agreement.

As an entity that is created by the City Charter, the System could be viewed as constituting a legal subdivision of the City. While it may have independent fiduciary responsibilities to the System's beneficiaries, the System is not an agency established under any other governmental authority (such as separate enabling legislation enacted by the Legislature). As such, it may merely be a separate subordinate entity within the City government that

[2] All statutory references are to the California Government Code unless otherwise noted.

technically can not "contract" with the City because it is part of the City.[3] Therefore, we must first consider whether the agreement between the City and the System may not be a "contract" at all for purposes of Section 1090, but merely an internal arrangement within a single governmental entity.

A number of cases have examined situations in which there was uncertainty as to the separate identity of affected governmental entities. In People v. Gnass (2002) 101 Cal.App.4th 1271, (a case coincidentally involving a Section 1090 violation) the court addressed a situation where an attorney represented a two related public entities and then received fees as the result of a bond transaction from a third related agency for which he served in a private capacity. In his defense, the attorney attempted to separate the agency that paid him as a private counsel from others that he represented as a public official.

Gnass was City Attorney for the City of Waterford, and also represented the Waterford Public Financing Authority (Waterford PFA), a joint powers authority (JPA) that was formed by the City and its redevelopment agency. The Waterford PFA then participated in the formation of a series of other JPA's that issued bonds to fund various projects around the state pursuant to the Marks-Roos law (the "Marks-Roos JPA's"). Gnass received legal fees as a disclosure counsel for the bond offerings made by the Marks-Roos JPA's. It was alleged that this arrangement violated Section 1090, because the Waterford PFA had entered into contracts with the various Marks-Roos JPA's that ultimately resulted in the payment of legal fees to Gnass as disclosure counsel in the bond financing. In reaching its conclusion that Gnass had acted in his public capacity in "making" the contract that had a private benefit to him, the court found that the "nice legalistic differences" between the City and the Waterford PFA were "not determinative" of the matter, since Gnass had essentially served, at one time or the other, as the attorney for both agencies. It was not necessary to find that Gnass had served in an official capacity for the Marks-Roos JPA's, although the court hints he may have done that as well.

In essence, the court in Gnass looked beyond the separate status of the agencies to find that he had represented the Waterford PFA in his public capacity in its formation of the Marks-Roos JPA. This resulted in a prohibited interest as a result of his expectation of receiving legal fees related to the bond financings for which the Marks-Roos JPA were formed. Thus, in this situation, the court compressed the separate legal entities into a single group interest in order to find that the attorney had been disloyal to his public office. However, this may not have been entirely necessary as the court appears to have reached its conclusion on the basis that Gnass represented the Waterford PFA while it entered into contracts to form the various Marks-Roos JPA's, knowing that he would receive fees in completing the bond deals of these JPA's. Nevertheless, if the Gnass court's reasoning regarding the identities of the various entities were to be applied in this case, a court might also avoid finding any "legalistic differences" between the

[3] In other large cities, agreements between separate agencies within the city are often termed "Memoranda of Understanding," between subordinate agencies of the city (as opposed to "contracts" between separate legal entities).

City and the System by viewing the bodies as a single entity (and therefore finding no prohibited contract).

In making its holding, the Gnass court refused to rely on two cases cited by the defendant, in which courts declined to view related entities as having a single existence. In both cases (Rider v. City of San Diego (1998) 18 Cal.4th 1035 and Vanoni v. County of Sonoma (1974) 40 Cal.App.3d 743), the courts refused to apply debt limitations applicable to one agency to the actions of a separate but related agency on the grounds that the second agencies had a separate statutory basis. In the Vanoni case, the Court noted that the Legislature had specifically provided for the formation of a "Sonoma County Flood Control and Water Conservation District" that was separate and apart from the County of Sonoma, despite having the same boundaries, a shared governing board and having its taxes collected in the same manner. In the other, the court found that a JPA formed by the City of San Diego and the San Diego Unified Port District was indeed an entity separate from the City. (The statute permitting the formation of JPA's clearly provides that they may be separate legal entities from their member entities. *See* Gov't. Code § 6507.) In both cases, the courts made it very clear that the statutory authority for the creation of each independent agency was an important determining factor.

There is statutory authority for cities to create retirement systems that do not involve the creation of a separate entity (*See* Gov't. Code § 45300 et seq.). However, the System was created and organized under the Charter.[4] Nevertheless, the argument that the System is a component part of the City is certainly bolstered by the fact that the legislation authorizing the formation of an analogue system does not provide for it to be a separate government entity. (Section 45316 notes that it is an alternate procedure and case law has held that Charter cities are free to adopt pension plans that differ from the statute. (Bellus v. City of Eureka (1968) 69 C.A. 2d 353)). Therefore, based on Vanoni and Rider, as well as the statutory framework for municipal retirement systems, a court should conclude that the System is part of the City and an agreement between the City and the System is not a contract for purposes of Section 1090.

A recent Attorney General's opinion addressed potential contracts between a city (San Francisco) and a for-profit corporation that was entirely owned by the city, when the City's Airport Director and a member of its Airport Commission, acting in those capacities, participated in the making of the contract while also serving as members of the board of directors of the non-profit. Finding that the two individuals in both roles would be acting in the best interests of the city, the Attorney General's office opined: "We do not believe that Section 1090 has any application where the contract is between a public agency and its wholly-owned corporation, regardless of whether is non-profit or for-profit." (81 Ops.Cal.Atty.Gen. 91, 93.) It should be noted that this opinion was based, in part, on the fact that the two individuals "will not be receiving any personal gain" as a result of the contract and therefore would have undivided

[4] There are other statutes that establish certain other retirement systems (*See* Gov't. Code § 9320 et seq. (Legislative Employees); § 31450 et seq.) (County Employees)).

loyalty to the city while acting in both roles. (That may not be the case with regard to the System, since the board members will receive benefits from System. Therefore, placing too much reliance on this opinion may be risky.) The Attorney General also notes that he would decline to apply 1090 where it "would not serve the purposes of the Legislature in enacting section 1090" despite the absence of a clear statutory exemption. (Id. at 94.) Hopefully, a court would take a similar stance with regard to the System. Even if a court were to find that the System was a separate entity from the City, there is legal precedent for finding that 1090 might not apply.

b. **Contract was Developed, Negotiated or Approved by Persons Covered**

A second element of a potential 1090 violation requires that the contract be "made" by a person (or a body or board of which that person is a member) who is covered by Section 1090. Section 1090 has a wide reach. According to the California Attorney General's publication on the subject "[v]irtually all board members, officers, employees and consultants are public officials within the meaning of section 1090." The aspect of "making" the contract can involve a wide range of actions, including preliminary discussions, negotiations, reasoning, planning, and advising with regard to the subject of the contract.

(i) **City didn't intend for 1090 to apply to Board**

While it may appear that the City/System agreement was made by individuals who are covered persons under the statue, it is possible to make an argument that, in establishing the Board and naming to it individuals who would so clearly have financial interests in the Board's actions, the City Charter may have intended that Section 1090 **not** apply to the Board. The authors of the Charter were fully cognizant that the Board would make decisions that would have an impact on the current and retired employees of the City. Given the "conclusive presumption" that any contract made by a board that has even a single member with a prohibited financial interest under 1090 is void, application of 1090 means that the City Charter would have essentially established a board that could not function in achieving its main purpose. That clearly could not have been their intent.[5] (This may not be controlling, however, as the Legislature apparently didn't intend for local agencies to have the option of exempting officials from Section 1090's reach.)

A stronger argument is that the application of Section 1090 to the

[5] Although there is a "rule of necessity" that allows boards to act when one of their members has a conflict, that rule also requires that the members with the conflicts not participate in the action. (69 Ops.Ca.Atty.Gen 102.) However, when this rule is applied to the Board, the three City officers, the three employees and the retired employee would all be disqualified, leaving many of the important decisions of the Board up to the four public members. That would hardly have been the intent of the drafters of the Charter provision establishing the System.

operations of the Board creates a potential conflict with the provisions of the Charter (which intended that the specified individuals make the required decisions of the System). In that case, we would need to apply the principles that have been developed to address conflicts between state laws and local provisions that address "municipal affairs."

As a charter city, the City may "make and enforce all ordinances and regulations in respect to municipal affairs, subject only to the restrictions and limitations provided" in its charter. (Cal. Const. Art. XI, Section 5.) City charters adopted under the Constitution "with regard to municipal affairs shall supersede all laws that are inconsistent therewith." Otherwise, the City is subject to the general laws of the state. It has been conclusively held that the establishment of pensions and pension systems is a "municipal affair." (Murphy v. City of Piedmont (1936) 17 Cal.App.2d; City of Downey v. Board of Administration, Public Employee Retirement System (1975) 47 Cal.App.3d 621.) However, Section 1090 regulates the operation of the System, not the City's power to create it. In order to address the potential conflict between Section 1090 and the Charter's provisions establishing the System, a court would look to the case law that has interpreted Article XI, Chapter 5. An analysis of the two seminal cases addressing conflicts between charter city legislation and state law provides some very useful guidance in navigating this often-confusing area.

In two cases, California Federal Savings and Loan Assn. v. City of Los Angeles (1991) 54 Cal.3d 1 ("Cal. Fed.") and Johnson v. Bradley (1992) 4 Cal.4th 389 ("Johnson")[6], the California Supreme Court reexamined and restated the process for analyzing conflicts between charter city laws addressing municipal affairs and general state statutes. As these cases show, the task is not an easy one. The threshold inquiry is deciding whether there is an actual conflict between the two laws. As the court in Cal. Fed. stated: "To the extent difficult choices between competing claims of municipal and state governments can be forestalled in this sensitive area of constitutional law, they ought to be; courts can avoid making such unnecessary choices by carefully insuring that the purported conflict is in fact a genuine one, unresolvable short of choosing between one enactment and the other." (54 Cal.3d at 16-7.) The Cal. Fed. court notes two cases (Bishop v. San Jose (1969) 1 Cal.3d 56 and Weekes v. City of Oakland (1978) 21 Cal.3d 386) in which it found "no real conflict."

As the Cal. Fed. decision notes, if a genuine conflict is found between a local law addressing a municipal affair and a state statute, a court must then determine whether the state law addresses a statewide concern. Otherwise, the municipal law is beyond the reach of state legislative control. If however, the state statute addresses a matter of statewide concern and is reasonably related to its resolution, then the state law controls. Essentially, the analysis then boils down to whether, "under the historical circumstances presented, the state has a more

[6] Cal. Fed. struck down the imposition of a municipal business license that conflicted with a statewide scheme to limit local taxation of savings and loan associations, while Johnson upheld a local program for publicly financing campaigns in light of a claim that it was invalidated by a state initiative that prohibited such programs.

substantial interest than the charter city." (Cal. Fed., 54 Cal.3d at 18.) Thus, in cases presenting a true conflict, "the hinge of the decision is the identification of a convincing basis for legislative action originating in extramunicipal concerns, one justifying legislative supersession based on sensible, pragmatic considerations." (*Id.*)

In our case, a court should be able to avoid finding an "actual conflict" between the Charter provision establishing the make-up of the Board and Section 1090, by finding that 1090 does not extend to agreements between different agencies of the City government. That way, the Court could permit the City to establish the Board with the make-up it feels to be optimal, without creating a conflict with state law.

However, if a court were not to accept that argument, it would be difficult to argue that 1090 did not address a matter of statewide concern. In our highly interdependent state, no tenable argument can be made that only the citizens of a particular city have an interest in the absence of public corruption. Clearly, businesses, property owners, other government agencies, as well as citizens of adjoining municipalities, all may be affected by a corrupt city government. In fact, as the court in Johnson noted: "[W]e agree with petitioners that charter cities may not enforce laws that are inconsistent with or impede statewide regulation of the integrity of the political or electoral process . . . ." (Johnson, 4 Cal. 3d 394, fn. 4.)

In this case, assuming the agreement between the City and the System is a "contract" within the meaning of Section 1090 and a court does not interpret Section 1090 such that a conflict is avoided, there is not much doubt that the members of the Board "participated" in making the contract when they voted to approve it. In fact, the law conclusively presumes that all members of a board that executes a contract, even those members who did not vote on the contract, are presumed to have participated in making it.

c. Financial Interest

The most difficult element of this analysis may involve the determination of the existence of a "financial interest." The statute does not define the term "financial interest," although it has been extensively explored in the case law and is generally defined very broadly. We will analyze it, and the specific circumstances of the agreement in question, below. In addition, the exemptions from Section 1090 mainly operate with regard to the financial interest element, defining certain interests to be either "remote interests" or "non-interests." We will look at the possible exemptions first.

(i) Interest in City Salary

With regard to the interest that six members of the Board may have with regard to the contract with the City, Section 1091(b)(13) holds that the interest of any employee of a governmental agency in his or her salary, per diem or reimbursement of expenses from a government agency is a remote interest. Therefore, the Board members who are City

employees would have a "remote" interest in an agreement between the System and the City due to their salaries. Thus the affected Board members could have disqualified themselves from the consideration of the contract with the City. An argument can be made that their interest was so obvious that no notice was required, but even if that was acceptable, it does not cure the fact that they may have actually participated in approving the contract (or simply been a member of a body or board that made a contract with an entity (the City) in which they had a financial interest (their salary)).

(ii) Interest in System Benefits

Another exemption that may be applicable here is listed in Section 1091.5(a)(3). It states that a public official shall not be deemed to have a financial interest in a contract when his or her interest is "that of a recipient of public services generally provided by the public body or board of which he or she is a member, on the same terms and conditions as if he or she were not a member of the board." The challenge here is showing that the payment of retirement benefits falls within the definition of a "public service." There is no case law interpreting this provision. I believe we are left with a straight statutory interpretation. It is clear that the System is really only intended to provide one thing—employee benefits. To the extent that public agencies are created to serve the public (in this case to provide benefits to public employees, which arguably insures their loyal service throughout their careers), that is the function the Board serves.

The preceding exemption is, in many ways, a restatement of an exception also used in the regulations implementing the Political Reform Act (PRA). This exception is based on the concept that actions that affect the "public generally" should not be the basis for a conflict of interest (presumably on the grounds that such a prohibition would prevent any action at all, as every citizen would be barred from action.) A specific regulation of the Fair Political Practices Commission, which implements the PRA, applies to members of board and commissions "who are appointed to represent a specific economic interest" and exempts them if the statute or ordinance creating the position requires them to represent that position, if the decision does not involve any other personal interests and the decision will "financially affect the member's economic interest in a manner that is substantially the same or proportionately the same as the decision will affect a significant segment of the persons the member was appointed to represent." (Title 2, Cal. Code of Regs. § 18707.4). This concept would clearly apply to the three members of the System as well as the retired member. It is more difficult to extend it to include the City Manager, Auditor and Comptroller and City Treasurer, as it is not clear that they were appointed to the Board to represent their personal interests in their retirement benefits. (However, it can also be argued that they were appointed to represent both their personal interest as recipients and the specific functions they serve with the City.)

(iii) Effect of Contract on Interests

As to the financial interest of the members, there may be some question whether the members of the Board actually had a financial effect in the agreement. As stated earlier, Section 1090 does not define what a "financial interest" is. However, the case law has examined the issue quite thoroughly and, applying the concept that the statute is to be "strictly construed," has found many types of situations to feature prohibited interests. The most telling comment on this process states "however devious and winding the chain may be which connects the officer with the forbidden contract, if it can be followed and the connection made, the contract is void." (People v. Deysher (1934) 2 Cal.2d 141.) It is essential that we analyze the exact effect of this particular contract will have upon the members of the System (and hence the members of the Board). If there is any chance at all that the City-System agreement will increase benefits (or even insure that the benefits promised in the City-Union agreement are paid), the City-System agreement would likely result in a financial interest on the part of the members of the Board that are also members of the System. It has been noted that by the time the contract was concluded, the City was fully obligated to provide the stated benefits and the contract merely provides a method to implement them. This may require further inquiry in order to be able to show that no financial effects resulted from the contract.

2. Special Conflict Rules

There is also precedent for the application of special rules to a conflict analysis. In several instances, courts have held that specific conflict provisions that differ from Section 1090 should be enforced in its place. (See Old Town Dev. Corp. v. Urban Renewal Agency (1967) 249 Cal.App.2d 313 and 51 Ops.Cal.Atty.Gen. 30.) However, in such instances there is a specific conflict provision that takes precedence over the more general provision of Section 1090. There is no such special statute present here, although perhaps an intent to have such an exception is inherent in the structure of the Board.

B. Effect of Conflict Upon Contract

If any member of the Board that acted on the agreement had a conflict under Section 1090, the law holds that the agreement would be void. Although the language of Section 1092 states that a contract made in violation of Section 1090 may be voided, case law has consistently held that such contracts are void, not voidable. (*See* Thompson v. Call (1985) 38 Cal.3d 633.) In addition, any entitlement to payment pursuant to a contract made in violation of Section 1090 is also void and the payment of any compensation is disallowed.

cc: CMH, MKT

EXHIBIT No. 46

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ADMITTED IN NEW JERSEY ONLY

May 13, 2004

Lawrence Grissom
Retirement Administrator
San Diego City Employees' Retirement System
401 B Street, Suite 400
San Diego, California 92101

RE: James F. Gleason, etc. v. San Diego City Employees' Retirement
San Diego Superior Court Consolidated Case No. GIC 803779
Our File No. 7835.56570

Dear Mr. Grissom:

This law firm represents San Diego City Employees' Retirement System ("SDCERS") in three consolidated actions currently pending before Judge Patricia Y. Cowett, of the Superior Court of the State of California, County of San Diego, under the lead caption, *James F. Gleason, et al., Plaintiffs v. San Diego City Employees' Retirement System, et al., Defendants*, San Diego Superior Court Case No. GIC803779 ("the *Gleason* litigation"). Pursuant to a vote of SDCERS' Board of Trustees (the "Board") on March 11, 2004, SDCERS conditionally agreed to settle the *Gleason* litigation according to terms stated in the February 19, 2004, document entitled "Settlement Terms In Concept That City Manager Will Recommend To City Council For Approval And Which SDCERS' Counsel And Litigation Representative Will Recommend To The SDCERS Board For Approval And Which Are Agreeable To Plaintiffs And Their Counsel" ("the Term Sheet"). On March 9, 2004, the City Council voted to approve settlement of the *Gleason* litigation pursuant to the provisions of the "Term Sheet."

Paragraph 8 of the Term Sheet states, in pertinent part: "SDCERS' approval is subject to review and approval by independent fiduciary counsel." SDCERS has selected Jan Webster, Esq., and Dan Riesenberg, Esq., of Pillsbury Winthrop, LLP, to serve as the independent fiduciary counsel required by the Term Sheet ("Fiduciary Counsel"). As part of its analysis, Fiduciary Counsel has requested that this firm, in its capacity as litigation counsel in the *Gleason* litigation, provide an analysis of the risks and benefits of litigating this action to a final enforceable judgment, rather than resolving it through settlement. This letter is presented to you on behalf of the Board in satisfaction of that requirement.

SUMMARY OF OPINION

1. It is reasonably probable that Plaintiffs' Motion for Summary Adjudication of the issue of whether Manager's Proposals I and II violate City Charter, Article IX, section 143, would be granted. An enforceable judgment allowing the Board to set new amortization rates would be delayed until mid 2006 to early 2007.

2. A bare probability exists that a court would conclude the Board breached its fiduciary duty by approving Manager's Proposal II. However, the nature of Plaintiffs' damage claim based thereon makes it unlikely that substantial monetary damages would be awarded on the basis of this claim.

3. It is probable the Court would conclude the Board's vote to adopt Manager's Proposal II violated Government Code section 1090, thereby invalidating the vote.

4. It is possible that a court order invalidating Manager's Proposals I and II on a going forward basis could result in a greater net monetary recovery for SDCERS than would be obtained under the settlement. However, it is probable that an enforceable judgment would be delayed by appeals until approximately 2007. Furthermore, any right to increased payments in the immediately ensuing years would not be protected by any form of collateral to secure such payments. The Board would incur approximately $300,000 to $500,000 in additional attorney's fees and costs to obtain a final judgment under this scenario.

5. It is unlikely that a court would enter an order invalidating Manager's Proposal II, but permitting selective enforcement of Manager's Proposal I in such a manner that resulted in a superior monetary recovery than would be obtained under the settlement.

6. It is probable that the Court would enter an order permitting some amount of restitution for past underfunding by the City. However, we cannot predict with any reasonable certainty what amount might be awarded. Furthermore, an enforceable judgment under this claim would likely be delayed by appeal for a period of between 18 months and three years. SDCERS would incur approximately $300,000 to $500,000 in additional attorney's fees and costs during this time.

7. The settlement achieves substantially all of the most likely results of a litigated resolution of this matter, and does so far sooner than would be accomplished

under a litigated resolution, at a lower cost to SDCERS. It substantially increases the amount of money contributed to SDCERS in the upcoming fiscal years, it returns SDCERS to an actuarially-based contribution method, and it allows the Board to implement the most recent changes in actuarial assumptions significantly sooner than would otherwise be possible.

BACKGROUND

Our analysis is based on the following sources of information. This firm has been counsel of record for SDCERS in the *Gleason* litigation since its inception, a period of approximately 17 months. During that time, we have reviewed approximately 100 bankers boxes of documents from sources including: SDCERS, Gabriel, Roeder & Smith ("GRS"), Hanson Bridgett, the City, and Morrison & Forester, out of which we have produced approximately 10,000 pages of documentation. We have conducted approximately 100 hours of interviews with SDCERS Staff, Trustees, Actuaries, Fiduciary Counsel, and independent third party witnesses. We have participated in the depositions of the following individuals: Lawrence Grissom, Fred Pierce, Ron Saathoff, Terri Webster, Cathy Lexin, Mary Vattimo, John Torres, Robert Blum and Constance Hiatt. We have reviewed transcriptions of SDCERS Board meetings conducted in June, July and November 2002. We have conducted legal research relevant to the claims and defenses implicated by the causes of action stated in the *Gleason* litigation.

Reference to specific items of evidence in the following sections is not, and should not be construed as, a comprehensive or exclusive list of evidence relevant to the particular issue addressed, but is instead intended to provide an example of the evidence which might bear on the particular issue, should this matter proceed to trial.

SUMMARY AND ANALYSIS OF THE FACTS

In the event this matter had proceeded to trial, and thereafter appeal, the following facts would likely have been proven by a preponderance of the evidence. Thus the following facts constitute the record upon which the issues of law presented in the *Gleason* litigation would have been decided.

A. The '96 Agreement ("Manager's Proposal I").

In or about June 1996, the City Manager proposed an "Employer Contribution Rate Stabilization Plan" ("Manager's Proposal I"). The principal feature of Manager's Proposal I was that contribution rates would be set based on an agreed rate between the City and SDCERS independent of the contribution rate derived from calculations by SDCERS' actuary, Rick Roeder of GRS. Under Manager's Proposal I, contribution

rates would be calculated on the basis of the projected unit credit (PUC) actuarial method, with specified contribution rates in the ensuing two fiscal years of 7.08% and 7.33%. Thereafter, the contribution rate would increase by 0.50% each year until the contribution rate reached the rate calculated on the basis of the entry age normal (EAN) actuarial method. Significantly, the City Manager's proposal also specified:

> "In the event that the funded ratio of the System falls to a level 10% below the funded ratio calculated at the June 30, 1996 actuarial valuation...the City-paid rate will be increased on July 1 of the year following the date of the actuarial valuation in which the shortfall in funded ratio is calculated. The increase in the City-paid rate will be the amount determined by the actuary necessary to restore a funded ratio no more than the level that is 10% below the funded ratio calculated at the June 30, 1996 actuarial valuation."

The City Manager's stated reason for presenting the "Employer's Contribution Rate Stabilization Plan" was the unanticipated fluctuation in the Employer's Contribution Rate under the projected unit credit actuarial method adopted in 1992.

Several witnesses have testified that Manager's Proposal I was presented to the Board for approval contemporaneously with the City's negotiation of new labor contracts with its unions. These negotiations included promised retirement benefit enhancements for union members. Pursuant to City Charter, Article IX, [1] Section 144, a majority of the Board was comprised of individuals whose pensions would have been affected by the outcome of the City-Union labor negotiations.

1. **First Opinion Issued by Fiduciary Counsel.**

The question of whether the Board would be discharging its fiduciary duties in adopting Manager's Proposal I was submitted to fiduciary counsel for an opinion. Counsel noted that nothing in the proposal "changes the Board's discretion to adjust the actuarial assumptions on which the System is based as needed in order to insure the long term funding integrity of the System." This comment, however, failed to take into account that Manager's Proposal I required the contribution rates be set independent of actuarial calculations, such that changes in actuarial assumptions would have no effect on contribution rates over the lifetime of the agreement. Nonetheless, counsel concluded:

[1] Unless otherwise specified, all section references to the City Charter are to Article IX thereof.

> "Provided the City-paid rate in the [Plan] is not less than an amount substantially equal to that required of employees for normal retirement allowances as certified by the actuary, the Board will be acting within the discretion granted to the Board to administer the System and discharging its fiduciary duties set forth in Article XVI, Sec. 17 of the California Constitution."

Counsel's statement derived from (without referencing) City Charter section 143, the determinative provision in the *Gleason* litigation. Counsel's allusion to section 143 drew only on one phrase ("The City shall contribute annually an amount substantially equal to that required of the employees for normal retirement allowances..."), but failed to reference, let alone analyze, the subsequent phrase ("...as certified by the actuary...") which became the cornerstone of the Plaintiff's case in the *Gleason* litigation. Moreover, counsel's letter provided no analysis of the final sentence of section 143, which again references the interdependent relationship between SDCERS' Board and Actuary in all matters relating to the retirement system's operation.

2. <u>Additional Opinions Issued by Fiduciary Counsel.</u>

In response to questions from members of the Board, fiduciary counsel issued a second opinion addressing SDCERS' duties under *Claypool v. Wilson* (1992) 4 Cal.App.4th 646, and related cases. The Board wanted to ensure that the modification of vested pension rights which would result from adoption of Manager's Proposal I were "offset" by an "increase in benefits and other advantages granted to the beneficiaries" of SDCERS. In an apparent reference to promised retirement benefit enhancements at issue in the concurrent collective bargaining process, counsel noted that "other aspects of the City Manager's proposal" conferred increased benefits on the SDCERS members. This, combined with the conclusion that "stabilization of employer contribution rates is directly related to the functioning and integrity of the system," led counsel to conclude the Board was acting in a manner consistent with its duties under *Claypool*.

In its second opinion letter, fiduciary counsel also addressed two additional issues raised by Board members, that remain relevant to the *Gleason* litigation. First, counsel noted the Board is held to the standard of professional bankers and bank investment advisors, and therefore has "a duty to determine the financial viability of the City before it approves contribution payments at a level less than that recommended by the actuary." Failure to carry out this duty, counsel noted, would be a breach of fiduciary duty. After reviewing the available information, counsel concluded a process existed

through which the Board could satisfy itself of the City's financial viability. Testimony elicited by Plaintiff's counsel in the *Gleason* litigation from several witnesses shows such an investigation was never undertaken, let alone completed to the satisfaction of fiduciary counsel or the Board.

Next, counsel noted that, because "the Board has no authority to determine benefits or to make benefit changes," it "should not engage in negotiations for benefit changes or increases." Nonetheless, certain Board members inquired as to whether the "real conflict" presented by Board members voting on proposals which would confer financial benefits on themselves would prevent those Board members from voting on the proposal. Fiduciary counsel noted that the City Manager's proposal made adoption of increased benefits in the concurrent labor negotiations contingent on approval of reduction of the City's funding obligation. However, counsel noted the drafters of the City Charter (through which SDCERS was established) "were aware of possible conflicts of interest inherent in the appointment of those [financially interested] members of the Board." Under these circumstances, counsel opined, the "bare potential for a conflict of interest does not categorically bar a fiduciary from functioning as a trustee." Counsel did not, however, notify the Board of the existence of Government Code section 1090,[2] nor provide any analysis of its effect on the Board's ability to deliberate or vote on the issue before it. Notwithstanding this omission, counsel concluded:

> "[I]t is our opinion that those Board members who voted in favor of the proposal solely in the interest of, and for the exclusive purposes of providing benefits to participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system, did not have a conflict of interest sufficient to bar him or her from functioning as a trustee."

According to Mr. Roeder, the performance of relevant financial markets during the 1996 through 2000 time frame caused the funded ratio to far exceed the "trigger" established by adoption of the '96 Agreement. Mr. Roeder noted it was generally accepted that the funded ratio trigger was 82.3%, but because the funded ratio never

[2] Government Code section 1090 states: "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." This section applies to persons in the position of SDCERS Board members. (Govt. Code § 82048.)

approached that level, certain potential ambiguities in Manager's Proposal I were never resolved.

B. The 2002 City Manager's Proposal ("Manager's Proposal II").

On June 10, 2002, the City Manager, on behalf of the Mayor and City Council, requested that SDCERS approve an amendment to Manager's Proposal I as follows:

> "The floor for the actuarial funded ratio of SDCERS will be established at 75%.
>
> "The City will pay contributions at the 'agreed to' rates for FY96 through FY07 as contained in the Manager's Proposal. If the actuarial funded ratio falls below the floor in any year, the City will increase its contribution rate on July 1 of the following year by an amount equal to one-fifth of the amount necessary to reach the full actuarial rate. The City will pay this increased amount for each of the subsequent four years in order to achieve the full actuarial rate over a five year period."

The City Manager identified as the basis for the proposed amendment several "unprecedented events" during the preceding two years, including the events of September 11th, "the collapse of the dot com industry," the "overall fall in the investment market," the "specific loss of revenues in the San Diego economy, and the anticipated raid on local revenues by the State of California."

Contemporaneous documents, as well as testimony of multiple witnesses in the *Gleason* litigation, prove that – as with Manager's Proposal I -- Manager's Proposal II was linked to the City's collective bargaining with its unions over new labor contracts. The evidence is clear that the City promised its unions enhanced retirement benefits, contingent on the Board's adoption of Manager's Proposal II. The evidence is likewise clear that the linkage between enhanced retirement benefits for City employees, and adoption of a new "contribution agreement" was repeatedly emphasized in communications between City labor negotiators and SDCERS Board members.

1. Opinion Issued by Fiduciary Counsel.

SDCERS requested an opinion from its current fiduciary counsel, Robert Blum, Esq., as to whether adoption of Manager's Proposal II was consistent with the Board's fiduciary duties. In an unsigned draft opinion letter dated June 12, 2002, Mr. Blum summarized the circumstances leading to the City Manager's request for adoption of Manager's Proposal II, including: the total of contributions by the City and members to

SDCERS was insufficient to cover the normal cost and interest on past service cost computed at the actuarial funding rate; from July 1996 to June 2002, the difference between actual City contributions and actuarially calculated contributions totaled approximately $90 million; and, "it is estimated that as of June 30, 2002, SDCERS funding ratio will be close to 82.3%." The last factor listed by Mr. Blum was clearly the most critical from the City Manager's perspective, insofar as "hitting the funded ratio trigger" would, according to one interpretation of Manager's Proposal I, (supported by at least a plurality of the Board,) require an immediate additional cash contribution of between $25 million and $75 million.

Mr. Blum noted that since Manager's Proposal I was executed, the law governing employees' interests in their retirement system had been "substantially strengthened," thus limiting the ability of employers to alter contribution obligations in a manner that affected vested benefits. Moreover, Mr. Blum noted that the ability to "mitigate" funding reductions through provision of "comparable new benefits" was "not governing with respect to the Board's responsibility to act prudently. If it were governing then each time that employer persuaded a Board to reduce contributions, it could avoid challenges by increasing benefits. That would not pass elementary actuarial requirements."[3]

Significantly, Mr. Blum noted that one of the questions left unanswered by the City Manager's proposal was the means by which the City would fund its contribution obligation under the proposed modification to Manager's Proposal I. Again, testimonial evidence elicited in the *Gleason* litigation shows the issue of "investigating the City's ability to pay" was not done, despite the warnings of fiduciary counsel in both 1996 and 2002.

After more than a dozen pages of analysis, Mr. Blum's unsigned draft opinion concluded:

> "Under the facts as we understand them, and for the reasons discussed above, *it is our opinion that there is a material risk that if the Board were to agree to the proposed amendment to the Manager's Proposal in its current form, and if this decision were challenged in court, a court would hold that the decision was not a proper exercise of the Board's fiduciary responsibilities based upon the facts before the*

[3] Mr. Blum's opinion on this issue appears to directly contradict at least one basis upon which prior fiduciary counsel opined that adoption of Manager's Proposal I was a proper exercise of the Board's fiduciary duties.

> *Board and the actuaries [sic] opinion to the contrary.* A court would look at whether the Board had substantial evidence to support the propriety of its actions and there is a material risk that a court would find such evidence lacking." (Emphasis added.)

2. Mr. Roeder's Presentation Regarding Manager's Proposal II.

On June 12, 2002, SDCERS' actuary, Mr. Roeder, made a presentation to the Board that was critical of Manager's Proposal II. Among the most important points Mr. Roeder made were the fundamental inconsistency, from SDCERS' point of view, between the "enhanced benefits" aspect of the proposal, and the "contribution relief" aspect of the proposal. Mr. Roeder also laid out the following facts, which he concluded were relevant to the Board's decision:

(a) SDCERS' role should be largely independent of the setting of existing or potential benefit levels;[4]

(b) Existing benefits for City employees were not below average compared to other state and national public systems;

(c) SDCERS is one of the few retirement systems to use PUC funding, and on that basis has one of the lowest funded ratios in California; moreover the existing funded ratio is at its lowest point since the 1980's; and

(d) The gap between the computed PUC actuarial rate and the City contribution rate has been increasing since implementation of the '96 proposal.

Mr. Roeder also noted several mitigating factors. Foremost among them, it appears, was that SDCERS would "be able to make benefit payments over the next 10-15 years regardless of the decision made to grant potential additional funding relief."

In his presentation to the Board, Mr. Roeder stated, "What the City proposes is *outside the norm for generally accepted actuarial funded policies* (emphasis added)," a

[4] Despite having been prominently discussed in the '96 fiduciary counsel opinion letter, this appears to have been the only instance in which SDCERS' unwilling involvement in labor negotiations was mentioned in the process by which Manager's Proposal II was analyzed.

circumstance which he felt "place[d] an added burden in our view as trustees to exercise our fiduciary responsibility appropriately." Mr. Roeder stated that if the Board was "willing to accept this version of the manager's proposal, I want everyone here to be totally cognizant of the fact that the way I understand the current version is it will [be] possible for the funded ratio to go below 75 percent and possibly significantly below." Finally, Mr. Roeder made clear he was more comfortable with Manager's Proposal I because of the "hard floor" of 82.3%.[5]

Transcripts of the June 2002 Board meeting document the differences of opinion that existed among both Board members and Staff regarding the proper interpretation of Manager's Proposal I's "catch-up" provisions. At issue was whether the entire underfunded amount came due in the immediately following year, or whether some longer term applied. Mr. Blum, along with Mr. Roeder, noted that under reasonably anticipated circumstances, if the funded ratio fell below 82.3%, as it was expected to do, the catch-up provision would require the City to contribute approximately $75 million in FY03.

3. The City Manager's Response.

On June 18, 2002, the City Manager issued a memorandum to SDCERS purporting to respond to concerns raised by Mr. Blum's June 12 draft correspondence. There appears to have been no attempt to respond to Mr. Roeder's concerns as expressed in his presentation. Significantly, despite Mr. Roeder's concerns over "dropping the hard floor" from 82.3% to 75%, the City Manager's memorandum left that provision unchanged. Additionally, the City Manager responded to Mr. Blum's concern regarding "funding status and anticipated earnings" over the later stages of Manager's Proposal II by stating:

> "This is a very broad question which includes the work initiated by the Mayor's Blue Ribbon Committee on City Finances, the SDCERS

[5] From the perspective of a litigation risk analysis, perhaps the most significant variable in the *Gleason* litigation is the fact that SDCERS' actuary, Mr. Roeder, was not deposed prior to execution of the Term Sheet. It is, of course, a certainty that should this matter proceed to litigation, Mr. Roeder would both be deposed, and likely become the central witness in the Plaintiff's case. Based on extensive review of Mr. Roeder's files, as well as many hours of formal and informal interviews, it is our opinion that Mr. Roeder's testimony would ultimately support a trier of fact in concluding that Manager's Proposal II was not an actuarially sound method for making contributions to a retirement system.

> subcommittee on surplus earnings and contingent benefits, and the need to develop a long term funding policy. It is recommended that a plan and schedule be developed to complete this policy work."

The only substantive modification to the original proposal was an increase in the City's "agreed contribution rate" from 0.50% to 1.00% effective July 1, 2004. This proposal is, at the very least, puzzling in light of the City Manager's non-response to Mr. Blum's questions concerning financing,[6] and the City's purported justification for seeking contribution reduction in the first place, i.e., that it expected the State to "raid" City revenue sources beginning in 2004, thus worsening its short-term financial outlook.

On July 3, 2002, the City Manager provided SDCERS with another memorandum "clarifying" the terms of the proposal, as well as responding to concerns by Board members. Significantly, the City Manager's "clarification" stated that the City had agreed to increased benefits for its employees during labor negotiations, "contingent" upon SDCERS accepting a reduction of its contribution obligation; yet in response to a Board member's question as to why SDCERS was placed in the middle of labor negotiations, the City Manager denied such a thing had occurred. Also significant was the City Manager's response to the Board's question of "why we should assume the City will find it easier to pay much higher pension costs in the future:"

"It will not be easier nor desirous, just necessary."

No further information was provided as to how the City would meet the contribution obligation outlined in its proposal.

4. **July 11, 2002 Board Meeting.**

On July 11, 2002, another Board meeting was held at which Mr. Blum provided an analysis of the effect of the "changes" the City offered in an effort to gain acceptance

[6] Discovery conducted during the *Gleason* litigation has produced only a single memorandum prepared by the City, purportedly in response to Mr. Blum's statements regarding investigation of the City's financial condition for purposes of determining its ability to meet the anticipated financial burdens of Manager's Proposal II. However, the City memorandum addressed only its superior credit rating, and not its ability to draw on existing or anticipated sources of revenue to meet its cash contribution obligations. The evidentiary record is otherwise silent as to any investigation by SDCERS of the City's ability to make annual contributions.

of Manager's Proposal II. At that meeting Mr. Roeder made clear that the 82.3% trigger would be hit in June 2003. Thereafter, the Board devoted its discussion to the difference in funding obligations between competing interpretations of Manager's Proposals I and II. After lengthy and detailed discussions, Mr. Saathoff proposed that the 75% trigger in Manager's Proposal II be replaced with the existing 82.3% trigger. Additionally, the modified proposal would incorporate the provision in the original Manager's Proposal II that gave the City five years after the trigger was hit to "reach the full actuarial rate."

In the final minutes of what was a very long meeting, before a vote was taken, the Board asked both Mr. Roeder and Mr. Blum whether adopting the proposal was "a prudent exercise of our responsibility." Mr. Roeder appears to have responded that the final version of the proposal fell somewhere between Manager's Proposal I and the original formulation of Manager's Proposal II. Mr. Blum stated it was difficult to give "an on-the-fly opinion," before concluding:

> "I can tell you it's a lot easier to give an opinion that you would not be at material risk. Exactly how far that opinion can go, exactly what the words are, that's a little difficult to tell you because we don't have the facts."

A vote was taken immediately thereafter, in which the modified Manager's Proposal II passed 8 to 2, with one abstention.

5. <u>Contract Negotiations.</u>

From July through November 2002, Mr. Blum and his partner, Constance Hiatt, prepared multiple drafts of a fiduciary opinion letter on the propriety of the Board adopting Manager's Proposal II. At the same time, Mr. Blum acted as SDCERS' lead negotiator with the City regarding the contents of the contribution agreement that would ultimately become the final version of Manager's Proposal II. As a result, Mr. Blum became the primary witness to the process by which Manager's Proposal II was created, endorsed and adopted.

Unfortunately, both Mr. Blum and Ms. Hiatt were ineffective witnesses when deposed in the *Gleason* litigation. Mr. Blum and Ms. Hiatt both testified that they "do not recall" researching, analyzing, or otherwise investigating, whether Manager's Proposal II would violate Charter section 143; nor was either lawyer able to recall having considered whether the Board's adoption of Manager's Proposal II would violate anti-financial interest laws such as Government Code sections 1090 et seq., or 87100 et seq. In any event, the opinion letter ultimately issued by Mr. Blum made no mention

whatsoever of the impact of sections 143, 1090 or 87100 on the Board's decision. Moreover, Mr. Blum was unable to explain the omission from his final opinion letter of more than two dozen facts regarding Manager's Proposal II which had been set forth in support of the negative conclusion stated in his June 2002 "draft opinion letter."

On November 7, 2002, Mr. Roeder provided certain written "statements in regard to the amendment to the Manager's Proposal."[7] From the perspective of the *Gleason* litigation, the most significant statements Mr. Roeder made were:

> "(c) It is likely that the 82.3% trigger point will be hit by June 30, 2003,...
>
> "(d) The higher the City's contribution levels, the better the funding status of SDCERS...
>
> "...
>
> "(g) From a pure actuarial viewpoint, it would be best to hold the City to the existing Manager's Proposal and the 82.3% trigger (particularly if one of the two 'high contribution rate' interpretations of the effects of hitting the trigger were to prevail)."

Mr. Roeder's letter did not include any statement to the effect that adoption of the modified Manager's Proposal II conformed to generally accepted actuarial principles, or that it was a prudent exercise of the Board's fiduciary responsibility.

On November 15, 2002, Mr. Blum reported to the Board on the results of his negotiation with City representatives regarding the provisions of the Memorandum of Understanding setting forth the final terms of Manager's Proposal II. Notwithstanding unresolved issues relating to linkage of benefit enhancements to contribution reduction, as well as investigation of the City's ability to make the projected contributions called for under Manager's Proposal II, the Board's discussion centered on assumptions underlying the exemplar calculations in the Memorandum of Understanding.

Significantly, the first mention of "indemnification" of the Board by the City for unspecified consequences of adopting Manager's Proposal II appears in the record of

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[7] A version of this letter dated November 5 also exists. The differences between the two versions appear immaterial, but have not been fully explored during discovery in the *Gleason* litigation.

the November 15 meeting. Transcripts of the hearing indicate the discussion became extremely contentious and acrimonious. It appears from both the minutes and transcript that the Board concluded Mr. Blum essentially supported adoption of the MOU because the Board had engaged in prolonged and difficult evaluation of the proposal before adopting it. The record does not include any discussion of the propriety of the Board's action in light of the relevant language from Charter section 143 or on the issue of disqualifying financial interests under Government Code sections 1090 or 87100 caused by the link between benefit enhancement and contribution reduction.

Furthermore, at least one Board member acknowledged that Mr. Roeder was "hesitant" to endorse the proposal. Mr. Roeder confirmed this interpretation of his feelings, stating that he felt it was "inappropriate" and placed the Board in "a no-win situation" of evaluating a contribution relief proposal that was linked to enhanced benefits for members. Nonetheless, the Board voted to adopt the MOU.

Three days later, on November 18, 2002, -- the same day on which Manager's Proposal II was dated and the City Council resolved to indemnify SDCERS' Board members -- Mr. Blum provided SDCERS with a signed opinion letter, containing an extensive, albeit retrospective, summary and analysis of the Board's decision to approve the modified Manager's Proposal II. Mr. Blum summarized the Board's decision as follows:

> "In essence, the Board decided to trade potential controversy over the meaning of the current Manager's Proposal and the possibility of receiving substantially higher contributions from the City if the 82.3% trigger is met in exchange for materially higher contributions if the trigger is not hit, lower contributions in the first five years if the trigger is hit, a date certain when the full PUC rate is contributed, and agreement on rapid movement to EAN starting at the end of the transition period."

Despite Mr. Roeder's multiple criticisms of Manager's Proposal II, Mr. Blum's only mention of Mr. Roeder's analysis was that the "transition period of moving the City to full PUC rates and then to EAN rates is reasonable based on the terms of the Agreement." Mr. Blum's reference to this limited aspect of Mr. Roeder's overall conclusion is puzzling, since Mr. Roeder explicitly stated that "from a purely actuarial viewpoint," he preferred there be no transition period. Mr. Blum's "final" opinion letter did not explain what caused him to omit numerous negative facts regarding Manager's Proposal II which appeared in his earlier draft opinion letter, nor did it

address section 143 or the Government Code's financial interest statutes. Unfortunately, testimony by Mr. Blum and Ms. Hiatt failed to shed any light on these omissions.

6. Execution of Manager's Proposal I..

On November 18, 2002, SDCERS executed the Agreement adopting Manager's Proposal II. Significantly, the recitals included a statement that SDCERS recognized that "under current fiscal circumstances, undue hardship would be imposed on the City if the Board were to require that the City immediately increase its contributions to the full projected unit credit rate calculated by SDCERS' actuary." Also significant was a previously unmentioned provision allowing the Board to "nullify this Agreement to the extent required by its duties established under the California Constitution and no one shall have any liability for losses or costs on account of such action."[8]

On the same date, SDCERS and the City executed an indemnity agreement, which provided "the City shall defend, indemnify and hold harmless all past, present and future members of the Retirement Board against all expenses, judgments, settlements, liability and other amounts actually and reasonably incurred by them in connection with any claim or lawsuit arising from any act or omission in the scope of the performance of their duties as Board Members under the Charter." Although referenced sporadically throughout the evidentiary record, there is no clear picture of precisely how or why this indemnity agreement was executed contemporaneously with documents relating to Manager's Proposal II. Informal interviews with Staff and City-affiliated witnesses suggest the City has such agreements with each of its related agencies, and that execution of this indemnity agreement was intended only to provide SDCERS the same protection provided to persons serving on other City-related entities.

SUMMARY OF THE LITIGATION

The *Gleason* litigation is comprised of three separate lawsuits, which were consolidated for all purposes on SDCERS' motion ("Complaint"). All claims stated in the three actions will be included in the class settlement, but are summarized separately below.

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[8] All witnesses, save Mr. Blum, recall that inclusion of the "nullification provision" was Mr. Blum's idea, and that it was incorporated in the MOU over strong objections from the City. Mr. Blum, however, testified this provision was the Board's idea, and that he simply followed instructions in negotiating for its inclusion in the final agreement.

A. *Gleason et al. v. SDCERS et al. ("Gleason I").*

This is the only one of the three consolidated actions to have been filed as a putative class action. The putative class is alleged to be "all those persons who are no longer employed by the City and are entitled to receive benefits from CERS."[9] The defendants in this action are SDCERS and the City of San Diego.

The gravamen of *Gleason I* is that Manager's Proposals I and II violate both Charter Section 143 and former Municipal Code section 24.0801 by failing to provide for funding of the Retirement System according to the "actuarially calculated rate." The Complaint states a first cause of action for declaratory relief that: (a) "the City has violated the City Charter by failing to fund its retirement plan as required by Article IX, section 143..."[10]; (b) the City has violated San Diego Municipal Code section 24.0801[11] by "failing to fund its retirement plan as required"; and (c) "the City has

[9] Pursuant to the Board's instruction, we have attempted to persuade the other parties to seek a class certification which will also include current City employees, such that approval of the settlement would bind both the class of current members of the retirement system, as well as future members. As of the date of execution of this letter, it appears unlikely the parties will agree to such class certification because of plaintiff counsel's new demand that the parties agree to the amount of fees he will be awarded as a condition to expanding the settlement class.

[10] Charter Section 143 states, in pertinent part: "The City shall contribute annually an amount substantially equal to that required of the employees for normal retirement allowances, as certified by the actuary, but shall not be required to contribute in excess of that amount, except in the case of financial liabilities accruing under any new retirement plan or revised retirement plan because of past service of the employees. The mortality, service, experience or other table calculated by the actuary and the valuation determined by him and approved by the board shall be conclusive and final, and any retirement system established under this article shall be based thereon."

[11] Prior to November 18, 2002, San Diego Municipal Code section 24.0801 stated, in pertinent part: "...the City shall contribute to the Retirement fund in respect to members a percentage of earnable compensation as determined by the System's Actuary pursuant to the annual actuarial evaluation required by Section 24.0901..."

As part of the enactment of Manager's Proposal II, this section was amended to state: "The City will contribute to the Retirement Fund, on behalf of Members employed by the City, the amounts agreed to in the governing Memorandum of Understanding between the City and the Board. The Actuary separately determines the City's contributions for General Members, Safety Members and Elected Officers. All

violated San Diego Municipal Code section 24.1111[12] by failing to fund its retirement plan as required."

The Complaint's second cause of action sought a judicial declaration that SDCERS breached its fiduciary duty to its members by allowing "underfunding" of the Retirement System, and whether such underfunding has "unconstitutionally impaired Plaintiffs' vested contractual rights."

Finally, the third cause of action sought in pertinent part:"(a) restitution by the City of all amounts owed to the CERS' [sic] trust fund as a result of the City's past violations of law;[13] (b) an injunction prohibiting the City from unlawful underfunding of the CERS' [sic] trust fund in the future; (c) money damages to the Plaintiff class for retirement benefits which could have and would have been paid but for the defendants' unlawful conduct..."

B. *Gleason v. SDCERS (Gleason II").*

This lawsuit was filed by Plaintiff James Gleason individually, naming only SDCERS as a defendant. The complaint alleges the City proposed to increase pension benefits for active City employees, conditioned upon the Board's adoption of Manager's Proposal II. The Complaint further alleges that certain SDCERS Board members (Cathy Lexin, Ron Saathoff, Terri Webster and Mary Vattimo)[14] had a "financial interest" in the proposed pension benefit enhancements within the meaning of that term as established by Government Code sections 1090 et seq., and 87100 et seq. Finally, the Complaint alleges the foregoing individuals failed to disclose their financial interest in the transaction before voting in favor of Manager's Proposal II.

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deficiencies that occur due to the adoption of any Retirement Ordinances must be amortized over a period of thirty years or less..."

[12] Section 24.1111 stated, in pertinent part: "The City shall contribute to the Retirement Fund a percentage of compensation earnable as determined by the System's Actuary pursuant to the annual actuarial evaluation. The required City contributions shall be determined separately by the Actuary for General Members and for Safety Members."

[13] Notwithstanding Plaintiffs' vaguely worded allegation, subsequent discovery and investigation indicates the amount of this damage claim would have been between $120 million and $130 million.

[14] Although Plaintiff could have named these individuals as defendants in this lawsuit, he did not. Thus, the individual Board members identified in this action have never faced personal liability for violation of either Government Code section 1090 or 87100.

The Complaint states a first cause of action for violation of Government Code section 87100 based on the participation of allegedly financially interested Board members in the vote on Manager's Proposal II. The first cause of action seeks relief in the form of an order "invalidating the decisions of CERS board of administration to approve the City's proposal." Plaintiff seeks precisely the same relief in his second cause of action for violation of Government Code section 1090.

C. *Wiseman v. SDCERS.*

The last of the consolidated actions was filed by Plaintiff Rosado Wiseman, individually, against only SDCERS. Although the gravamen of this action attacked the City's practice of appointing designees to sit on SDCERS' Board in place of the City Auditor and Comptroller and City Manager, the City was not named as a defendant. This action is based on the contention that Charter section 144[15] requires that the City Manager and City Auditor and Comptroller themselves sit on SDCERS' Board as Trustees of the Retirement System. The Complaint seeks an order invalidating SDCERS Board Rule 7.40, which states "[a]n ex officio Board member may designate a member of his or her staff to sit in the ex officio's place on the Board." Although the only purpose Plaintiff alleged for bringing the action was "that the parties can ascertain their respective rights and duties," the Court accepted SDCERS' argument in support of its motion to consolidate the three actions that this Complaint served as yet another vehicle by which the Plaintiff class seeks to invalidate the contribution agreements.[16]

LITIGATION ANALYSIS

The following analysis is organized according to the anticipated chronology of events should the *Gleason* litigation not be resolved by settlement, based on the order of significance to Plaintiff counsel rather than the order in which they appear in the three Complaints.

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[15] The relevant excerpt of section 144 states: "The system shall be managed by a Board of Administration which is hereby created, consisting of the City Manager, City Auditor and Comptroller, the City Treasurer,...Members of the Board, other than ex officio, shall serve six years or until their successors are elected..."

[16] We do not provide a detailed analysis of the merits of this action herein, insofar as the settlement will result in dismissal of these claims with prejudice, and we consider the potential effect of these allegations on our litigation analysis *de minimis*, at best.

A. Declaratory Relief Regarding Charter Section 143.

Plaintiffs' claim for declaratory relief regarding Charter section 143 is before the Court in the form of a Motion for Summary Adjudication, a procedure by which the Court may decide a discrete legal issue presented by the Complaint without resolving all disputed issues in a final judgment. Plaintiffs' Motion is made on the grounds that the plain language of Charter section 143 requires the City's employer contribution rates be derived from actuarial calculation, along with Board oversight and approval of the factors and assumptions used to perform such calculations. The effect of a ruling in Plaintiffs' favor on this issue would be to declare Manager's Proposal I and II illegal contracts, thus invalidating the "contribution agreement" method of funding on a going forward basis. SDCERS initially opposed Plaintiffs' Motion due to inclusion of several technical factual defects regarding funding level calculations. However, after Plaintiffs agreed to abandon their faulty arguments, and in an effort to strengthen our negotiating posture with the City, we withdrew SDCERS' opposition and filed a Notice of Non-Opposition to the Motion.

This issue would be the first to be decided by the Court, which would rule in advance of the trial date. Plaintiff counsel has stated that in the event the Court ruled in Plaintiffs' favor he would dismiss the remainder of the litigation to permit an expedited appeal of the trial court's ruling by the City, which would be certain to follow.

In our opinion, a significant possibility exists that the Court would grant Plaintiffs' Motion, and enter a declaratory judgement that Manager's Proposals I and II violate Charter section 143, and are therefore invalid. Our opinion is based on two significant factors.

First, the case law on which this issue would be decided favors Plaintiffs' interpretation of Charter section 143. The California Supreme Court held in 1983 that the City Charter, as amended in 1955, provides for "a retirement system in which contributions of the employees and City to the retirement fund are *computed on the basis of actuarial advice* designed to estimate the funding needed to accrue a guaranteed retirement allowance upon retirement." (*Int'l. Assn. Of Firefighters v. City of San Diego* (1983) 34 Cal.3d 292, 296.) The Supreme Court emphasized "the entire [retirement] system is based on actuarial advice." (*Id.* at 297.)

Courts of Appeal have followed the Supreme Court's characterization of defined benefit retirement plans as actuarially based. In an opinion addressing the issue inherent in the theory purportedly supporting Manager's Proposals I and II – that short term underfunding would be made up in later years – two Courts of Appeal have held, "[w]hen contributions are delayed beyond the date assumed [by the actuary], the plan

falls out of actuarial balance and actuarial soundness is endangered." (*Board of Administration v. Wilson* (1997) 52 Cal.App.4th 1109, 1140; *see also Bianchi v. City of San Diego* (1989) 214 Cal.App.3d 563, 571 ["the retirement system is a contributory system, based on actuarial tables established by the Retirement Board,...".) Thus, while no case has squarely considered the precise issue presented here, we conclude the foregoing authorities would influence the trial (and appellate) court's reasoning, disposing it favorably to Plaintiffs' interpretation of Charter section 143.

The second significant factor is a factual one. As the Board is aware, both the Securities and Exchange Commission, and the United States Attorney, are investigating whether any laws have been violated, in part as the result of allegedly misleading statements in City bond disclosure statements. One of the City's statements under investigation relates to its funding obligation to the Retirement System: "State legislation requires the City to contribute to CERS at rates determined by actuarial valuations." This statement appeared in bond disclosure documents issued while Manager's Proposals I and II were in effect. The bond disclosure documents were submitted to the Court as supplemental exhibits to Plaintiffs' Motion (after SDCERS filed its Notice of Non-Opposition). It is reasonable to anticipate the Court will interpret this statement as an admission by the City that Charter section 143 *does* require it to make contributions "at rates determined by actuarial valuations." The Court could properly disregard the City's subsequent contradictory statements made in support of its opposition to Plaintiffs' Motion. (*See Thompson v. Williams* (1989) 211 Cal.App.3d 566, 573 ["A party cannot rely on contradictions in his own testimony to create a triable issue of fact."].)

Therefore, based on the legal and factual foundation on which Plaintiffs' Motion is based, we conclude a significant possibility exists that the Court would grant the Motion. The effect of this Motion would be to invalidate, on a going-forward basis, Manager's Proposals I and II, and return the Retirement System to a contribution rate established by actuarial calculation, administered and approved by the Board.

Plaintiff counsel has stated, in the Court's presence, that in the event the Motion is granted he will likely dismiss the remainder of the *Gleason* litigation to allow for an expedited appeal of what he considers the central legal issue in this case. The time line for appeal, even under expedited circumstances, would result in an opinion from the Court of Appeal by approximately July 2005, and possibly as late as January 2006. In the event this action is not settled during the pendency of the appeal, a petition for review to the California Supreme Court would almost certainly be filed, further delaying enforcement of the trial court's ruling until late 2006 or early 2007.

It is extremely difficult to predict how the appellate courts would rule on this issue, particularly given the possibility of new case law being decided during the pendency of the appeal. However, the possibility that the trial court's ruling would be upheld by the court of final review cannot be dismissed as mere speculation. The factors identified as likely to influence the trial court's decision will also influence the appellate court's analysis. It is our opinion those factors work in favor of a conclusion supporting Plaintiffs' interpretation of Section 143. Thus, should Plaintiffs' Motion be granted, the Board would probably have an enforceable judgment allowing it to set contribution rates free of the limitations of Manager's Proposals I and II in calendar year 2006, although the final judgment could be delayed until early 2007.

D. Breach Of Fiduciary Duty.

Although Plaintiff counsel has stated his intention to dismiss the balance of the *Gleason* litigation in the event the Court grants the Motion for Summary Adjudication, we include in our litigation evaluation the following assessment of Plaintiffs' other claims.

Plaintiffs have stated a claim against SDCERS, as an entity (rather than against individual Board members) for breach of fiduciary duty arising from the decision to adopt Manager's Proposal II[17], as modified by the July 2002 vote. Plaintiffs' breach of fiduciary duty claim is styled as a cause of action for declaratory relief. However, Plaintiffs have included a declaratory relief claim regarding the amount of underfunding allegedly caused by the adoption of Manager's Proposal II. Therefore, it is technically possible for "damages" to be awarded based on this claim.

It is important to understand the nature of any such "damages" that might be awarded based on this claim. Plaintiffs' only interest, as members of the Retirement System, is in timely receipt of their individual pension benefits. Under these circumstances, Plaintiffs are only "damaged" by the alleged breach of fiduciary duty if they prove by a preponderance of the evidence that adoption of Manager's Proposal II causes them to receive less than the vested pension benefit to which they are individually entitled. Furthermore, SDCERS' actuary has stated in writing on several occasions – each of

[17] Plaintiffs' causes of action purport to attack the decision to adopt Manager's Proposal I in 1996, as well. However, we consider it at least probable that the Court would rule this aspect of Plaintiffs' claim is barred by the three year statute of limitations governing claims for declaratory relief, and therefore do not analyze this aspect of Plaintiffs' claim in any further detail. (*See Abbott v. City of Los Angeles* (1958) 50 Cal.2d 438, 463-464.)

which would be introduced into evidence at trial – that the Retirement System presently has sufficient funds to pay all benefits currently owed to existing retirees[18] as those benefits come due. Therefore, even in the event Plaintiffs prevailed on their claim for breach of fiduciary duty, we consider it unlikely that they could prove compensible damages as a result thereof.

Although we previously concluded Plaintiffs may prevail on their declaratory relief claim regarding Charter section 143, we do not consider it a certainty that they would therefore necessarily prevail on the associated claim for breach of fiduciary duty. It is important to bear in mind that the declaratory relief claim regarding Charter section 143 presents a narrow and technical issue of law which the Court considers without reference to the process by which the Board adopted Manager's Proposal II. Indeed, that process is irrelevant to the Court's decision making process in ruling on the Charter section 143 claim.

The breach of fiduciary duty claim presents a different question, one for which the Court must examine evidence regarding how Manager's Proposal II was presented, what the Board's response was, and ultimately, whether the Board's decision fell below the standards of reasonableness imposed on a fiduciary. A fiduciary breaches its duty to its beneficiary when it either (a) acts in a manner which fails to place the beneficiary's interests above those of the fiduciary, or (b) acts in a manner which is "unreasonable" under the circumstances. (Cal. Const., Art. XVI, §17, subd. (b); *Hittle v. Santa Barbara County Employees Retirement Assn.* (1985) 39 Cal.3d 374) Under the facts of this case, these tests could be applied interchangeably to the Board's challenged conduct.

Defense of the breach of fiduciary duty claim would center on several significant items of evidence. First, the Board rejected the original proposal in large part because it lowered the "funded ratio trigger" from 82.3%, which its actuary opined was an appropriate safeguard level, to 75%. In light of evidence which existed at the time showing a substantial likelihood that the funded ratio would fall below 82.3% in the

[18] Plaintiff counsel has questioned several witnesses during deposition regarding this assertion. It is clear from plaintiff counsel's questions that the rebuttal to this contention would center on the fact that the calculation assumes essentially all of the Retirement System's assets are used to meet pension obligations owed to existing retirees, with no amount allocated to future retirees. However, in light of the fact the plaintiff class (should this matter be tried) would consist exclusively of existing retirees, it is reasonable to anticipate the Court would exclude plaintiff counsel's argument as irrelevant to the claim asserted by the plaintiff class.

ensuing fiscal year, thus triggering "catch-up" provisions which increased the City's agreed contribution rate, the decision to reject this provision of the City's proposal and demand the 82.3% trigger remain in place constitutes substantial evidence of a proper exercise of the Board's fiduciary responsibility.

The Board also conditioned its approval on specification of the method and rate by which the City's contributions would increase in the event the funded ratio fell below 82.3%, thus adding further certainty to the Retirement System's near-term future. Further, the Board required the annual contributions be increased from the proposed rate of 50 basis points per year, to 100 basis points per year, thus halving the time in which the City would return to "full actuarial rate." Finally, the Board negotiated the inclusion of a "nullification provision," which permitted it to nullify Manager's Proposal II in the future if changed circumstances required it to do so in furtherance of its Constitutional duty to protect the long-term integrity of the Retirement System.

The Board also relied on fiduciary counsel for analysis and opinion. However, the tortured history of the opinion ultimately issued by fiduciary counsel[19] would likely undermine a jury's willingness to conclude the Board properly discharged its fiduciary duty based on this evidence.

While the foregoing list constitutes evidence in defense of the Board's decision, it is important to note that countervailing evidence exists which, in our opinion, is sufficient to meet Plaintiff's burden of proof on their allegation that adoption of Manager's Proposal II violated the Board's fiduciary duty to members of the Retirement System. Foremost on this list is the testimony of several witnesses that, despite having been advised to do so by more than one fiduciary counsel, the Board did not actively investigate the City's ability to make payments as promised. As noted in the factual summary above, the Board was warned on at least one occasion that it is held to the standard of a professional banker, and must investigate both the credit, and ability to

[19] We have detailed earlier in this letter several significant defects in fiduciary counsel's opinion, not the least of which is the almost entirely unexplained inconsistencies between the June 12 "draft" opinion and the November 18 "final" opinion. Almost equally significant is the lack of reference to, discussion, or analysis of, Charter section 143, the central issue in this litigation. Also disturbing is the lack of analysis regarding the means by which the Board might comply with Government Code section 1090, and thus guard against subsequent invalidation of its decision on such grounds. Given these significant questions, it is possible that the Court would conclude it was unreasonable for the Board to rely on fiduciary counsel's opinion without first having conducted further hearing and investigation of these issues.

pay, of someone seeking relief from a financial obligation by deferring all or part of that obligation beyond the existing due date. The Court could well be influenced by evidence from the Board's own fiduciary counsel, combined with testimony of its own witnesses, that it did not discharge this duty, thus jeopardizing the long term stability of the Retirement System by granting relief to an insufficiently creditworthy entity.

Second on the list of unfavorable evidentiary issues is the undisputed linkage between contribution relief and benefit enhancement. While reasonable explanations exist to rebut the inference that individual Board members' votes were influenced by this linkage, it is a truism of litigation that the party with the simplest explanation for an event is most likely to prevail. It is very simple to understand the concept of votes influenced by an expectation of corresponding benefits being bestowed; it is far more complicated to explain why that might not have happened in this particular instance. Evidence of the contribution relief-benefit enhancement linkage (particularly in light of questions surrounding fiduciary counsel's opinion) could dispose a Court (that had already concluded Manager's Proposal II violated Charter section 143) to likewise conclude the Board acted in a manner inconsistent with its fiduciary duties in voting to adopt Manager's Proposal II.

Finally, it is incontrovertible that Manager's Proposal I and II resulted in lower City contributions than would have been made under an actuarially based contribution system. A decision on the issue of breach of fiduciary duty will be made in the context of the facts recited above, but will ultimately come down to an analysis of the undisputed fact of underfunding in light of case law holding that "when contributions are delayed beyond the date assumed [by the actuary], the plan falls out of balance and actuarial soundness is endangered." (*Board of Administration v. Wilson, supra*, 52 Cal.App.4th at 1140.) Although we consider it difficult to predict the outcome of Plaintiffs' breach of fiduciary duty claim, we believe a probability exists that a Court would find in Plaintiffs' favor, although only a bare probability.

E. <u>Section 1090.</u>

Notwithstanding Plaintiffs' professed intent to dismiss their claim for violation of Government Code section 1090[20] should they prevail on the Motion for Summary

[20] The *Gleason* litigation includes companion claims for violation of Government Code sections 1090 and 87100, the latter being known as "The Political Reform Act of 1974." However, case law indicates that remedies for violation of section 87100 are generally used to obtain prospective injunctive and declaratory relief. It should also be noted that the Attorney General has opined on at least one occasion that analysis of a "financial interest" issue under section 87100 is appropriate "only where no conflict of

Adjudication, we consider it important to provide the Board with an analysis of this issue. One significant aspect of Plaintiffs' 1090 claim is that it is pleaded only against SDCERS, and not any individual Board members.[21] Therefore, under the current pleadings the Court could not impose personal liability on any individual Board members, which could otherwise result in disgorgement of any benefits such individuals allegedly obtained as the result of their actions. Instead, the only relief the Court could grant would be to void Manager's Proposal II, as having been adopted in violation of section 1090.

We consider it probable that the Court would find the Board's vote to adopt Manager's Proposal II violated section 1090. A violation of section 1090 will lie only where a public official makes a contract in which he has a "financial interest," whether direct or indirect, in the contract. (*Thompson v. Call* (1985) 38 Cal.3d 633, 645.) An individual has a financial interest in a contract if he or she "might profit from it." (*People v. Gnass* (2002) 101 Cal.App.4th 1271, 1289, fn.6.) An individual participates in the "making" of a contract if they: (1) actually participate in the vote to approve or adopt the contract, (2) are a member of the board that votes on the contract, even if they abstain from the vote, or (3) participate in negotiations regarding the contract, even if they are no longer a board member when the contract is adopted. (*Stigall v. City of Taft* (1962) 58 Cal.2d 565, 569; *Thompson, supra*, 38 Cal.3d at 649.)

A public official shall not be deemed to be interested in a contract if their interest falls within either the "non-interest" or "remote" exceptions to section 1090 established by section 1091.5 and 1091, respectively. "Non-interests" include the interest of a person receiving salary from a government entity, unless the contract directly involves the department of the government entity that employs the person, provided that the interest is disclosed to the board at the time of consideration of the contract, and provided further that the interest is noted in the board's official record. (§ 1091.5 (a)(9).) Likewise, "remote interests" include "salary from a government entity," only if the fact

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interest exists pursuant to [section 1090] but does exist pursuant to [section 87100]." (*In re Russell* (1978) 61 Ops.Cal.Atty.Gen. 243, 253.) Since Plaintiffs' purpose in pleading these claims is invalidation of Manager's Proposal II, we consider the section 1090 claim the far more likely basis for obtaining such an order, and therefore concentrate our analysis on that claim.

[21] Four individual Board members are identified in this claim (Vattimo, Saathoff, Webster and Lexin); however, none are named as defendants, nor are they otherwise parties to the litigation. Instead, they are identified for purposes of establishing the factual predicate for the alleged violation of section 1090.

of the remote interest is disclosed, noted in the board's official records, and the board approves the contract in good faith by a vote sufficient for the purpose without counting the vote of the interested officer. (§ 1091 (a)(13).)

Under the foregoing test, the issue of whether certain Board members were "financially interested"[22] in the vote to approve Manager's Proposal II is the most difficult to analyze, with one exception. Board members Lexin, Vattimo and Webster each were interested in the contract only to the extent of their interest in potentially enhanced pension benefits constitutes "salary" under section 1090.[23] The contract did not "directly involve"[24] the department of the City employing any of the foregoing individuals. Therefore, Manager's Proposal II did not trigger a "financial interest" as to these individuals. However, the record in this case does not include any evidence to show compliance with the "disclosure" and "record" elements of section 1091.5: none of these individuals publicly disclosed their interest in the contract, nor was such disclosure recorded in the Board's official records.[25] Therefore, there would be no

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[22] Under *City of Taft's* extremely broad definition of "participation," there is no question that all potentially interested Board members "participated" in the vote to approve Manager's Proposal II for purposes of a 1090 analysis. Therefore, we do not address this issue in any further detail.

[23] The law on the issue of whether pension benefits fall within the definition of "salary" *as that term is used in section 1090* is unsettled, unclear, and under accepted principles of statutory construction, contradictory. Unlike the Political Reform Act, other relevant Government Code sections, and supporting regulations, section 1090 does *not* include a definition of "salary" which incorporates pension benefits. Furthermore, all other definitions of "salary" which include pension benefits are restricted to Government Code sections *other than* section 1090. However, our analysis does not depend on this issue for its conclusion.

[24] Like the definition of "salary," there is surprisingly little guidance in the law on the definition of "directly involves" as that term is used in the context of section 1090. Some authority exists for the proposition that this term encompasses "contract[s] [which] would specifically affect [a person's] employing unit." (*In Re Aguilar* (1995) 78 Ops.Cal.Atty.Gen. 362.) This suggests the "employing department" need not be a party to the contested contract to be considered "directly involved" for purposes of section 1090. While our analysis does not depend on this issue for its conclusion, it should be noted that the current state of legal authority on this issue would certainly permit a reviewing court to reach a different conclusion than stated herein.

[25] It is important to note that section 1090 does not recognize a "good faith" exception to its application. (*People v. Gnass, supra*, 101 Cal.App.4th at 1271.) Thus, it is no

defense to the section 1090 claim based on either the "non-interest" or "remote interest" exceptions. It follows that a section 1090 violation could be based on the participation of Board members Vattimo, Webster and Lexin in the adoption of Manager's Proposal II.

Although some question might exist in the Court's mind regarding whether the interests discussed above would be sufficient to support an order voiding Manager's Proposal II under section 1090, the adoption of the "presidential leave" ordinance[26] affecting Board member Saathoff[27] presents a significantly more probable basis for invalidation of the agreement under this statute. In addition to the failure to comply with the "disclosure" and "record" elements of section 1091.5, it appears adoption of this ordinance implicated only Board member Saathoff's interests, and therefore would constitute an "individual" contract, rather than a contract between two public agencies, such that neither the "non-interest" or "remote interest" exceptions could be applied. (*People v. Gnass, supra*, 101 Cal.App.4th at 1303; *Finnegan v. Schrader* (2001) 91 Cal.App.4th 572, 579-83.)

It is important to note that no published decision exists which analyzes the issue of a disqualifying "financial interest" under section 1090 under the particular facts of this case, i.e., enhanced pension benefits. The absence of controlling authority on this issue creates some uncertainty as to how a court would rule on the issue of whether pension benefit enhancements qualify as either a "remote interest" or "non-interest" under the exceptions to section 1090's prohibition against participation in decisions on which the public official is financially interested. However, given the potential

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defense to claim non-compliance with this section resulted from good faith reliance on advice of counsel (or in this case, failure of counsel to so advise).

[26] It should be noted that the evidentiary record supporting a nexus between adoption of Manager's Proposal II and this ordinance is significantly weaker than the nexus between Manager's Proposal II and benefit enhancements for regular union members. However, our conclusion in this regard is heavily influenced by the very broad application of section 1090 to such agreements, the evidence that the relevant agreements were adopted close in time to one another, and involved negotiation by the same parties. On the basis of such a factual and legal record, we do not consider it probable that a Court would be willing to extend any "benefit of the doubt" on this issue to avoid finding a 1090 violation.

[27] Case law is clear that the participation of one financially interested Board member is sufficient to support voiding the agreement. (*See, e.g., Stigall, supra*, 58 Cal.2d at 566-67.)

magnitude of the financial benefits imparted through such a transaction, we consider the absence of controlling authority on the specific issue presented to be insufficient grounds for concluding a court would refrain from invalidating the contested decision under one of the statutory exceptions to section 1090's financial interest prohibition.

We conclude it is probable the Court would void Manager's Proposal II on the grounds it was adopted[28] in violation of section 1090. However, the Court's order probably could not be extended to Manager's Proposal I (whose adoption similarly violated section 1090) because Plaintiffs' claim is likely barred by the statute of limitations. (*See Marin Healthcare Dist. v. Sutter Health* (2002) 103 Cal.App.4th 861.) The effect of this potentially anomalous result is discussed in subsequent sections.

F. Summary of Negotiations Culminating in Proposed Settlement.

Settlement negotiations were originally conducted exclusively between counsel for Plaintiffs and the City, beginning in approximately October 2003. Upon discovering settlement negotiations had commenced, we inquired of both counsel as to why we had not been invited to participate from the inception of negotiations. Each of the other parties' respective counsel claimed it was his counterpart's idea not to initially include SDCERS.

Our concern from the outset of the litigation was that Plaintiffs and the City would negotiate a deal which would have the effect of "settling around" SDCERS, such that the City gained the benefit of ending the litigation, and Plaintiffs gained the benefit of a substantial attorney's fee award, while SDCERS – the entity to which any monetary recovery would properly flow – would realize no benefit whatsoever from a lawsuit purportedly filed to "fix" the retirement contribution problem. However, when it became clear that any settlement the parties might possibly agree to would involve resetting the amortization period upon which the City's employer contribution is calculated – an action within the Board's exclusive jurisdiction – we were confident SDCERS' interests would be taken into account in any settlement the parties ultimately reached.

[28] Although beyond the scope of this letter, it should be noted that it would have been at least technically possible for the Board to vote on Manager's Proposal II without violating section 1090, if appropriate disclosures and abstention procedures were followed. (§ 1091.5 (a)(9), (13); *see also In re Mack* (1986) 69 Ops.Cal.Atty.Gen. 102.)

In early November 2003, we began participating in a series of meetings between counsel and representatives for all parties intended to produce a compromise solution to the issues raised in the litigation. Based on instructions from the Litigation Representative, we did not offer an affirmative proposal during the first series of meetings. Instead, we provided information regarding hypothetical amortization schedules, contribution methods and other aspects of proposed settlement structures from which Plaintiffs and the City created numerous settlement scenarios (an estimated 25 to 30 hypothetical contribution analysis were prepared during this six week period). The result of the first phase of negotiations was a proposal by the City, and agreed to by Plaintiffs' counsel, which involved (1) starting a new 30 year fixed amortization period in Fiscal Year 2005, (2) during fiscal years 2005 and 2006, contributions would be made at a rate lower than the actuarial rate derived from the new amortization period, plus an additional $14,000,000 in FY 05 and 06, (3) contributions would be made according to the "new" actuarial rate beginning in fiscal year 2007, and (4) the "delta" between the City's contributions and the "new" actuarial rate (FYE 05-06) would be secured by real property.

We presented this proposal to the Board in December 2003. The Board quickly recognized the City's proposal would amount to approximately $75,000,000 *less* in City contributions than SDCERS would otherwise receive under Manager's Proposal II. We advised plaintiff counsel and the City's representatives of the Board's rejection of the proposal immediately following the December 2003 closed session. Both the City and plaintiff counsel reacted quite negatively. Plaintiff counsel threatened SDCERS with further breach of fiduciary duty claims for refusing to cooperate with the City's settlement proposal, while the City's representatives took the extraordinary step of writing directly to the Board to suggest it had somehow been misinformed by counsel regarding the settlement negotiation process.

In January 2004, we worked extensively with SDCERS' Executive Committee and Actuary to develop settlement proposal that SDCERS would find acceptable. SDCERS Board directed us to conduct further settlement negotiations with the objectives of: (1) resolving the litigation; (2) obtaining an outcome that was monetarily superior to Manager's Proposal II. Settlement negotiations were initially conducted under the supervision of the Honorable Howard B. Weiner, retired Justice of the Fourth District Court of Appeal. We presented two principal settlement scenarios, the first involving a split amortization schedule (15 year fixed for normal cost; 30 year fixed for UAAL), and the second involving a reset 30 year fixed amortization schedule, including updated actuarial assumptions adopted by the Board in February 2003, for FYE 2005-2008, following which the Board would be free to set whatever amortization schedule, and adopt any new actuarial assumptions, it deemed appropriate.

In the course of settlement negotiations, it became clear the determinative compromise would be on the amount of the City's contribution in FYE 05. The City representatives cited budget constraints relating to labor agreements which ran through Spring 2005 as the primary justification for the City's inability to make an FYE 05 contribution in the amount called for under the "hybrid amortization" proposal. In an effort to achieve the Board's directive of resolving the litigation in a manner which was monetarily superior to Manager's Proposal II, we thereafter focused on the limited 30-year fixed amortization proposal. A key objective in this regard was arriving at an actuarially based contribution schedule as quickly as possible. The City sought to make a FYE 05 contribution of approximately $110,000,000, instead of the $140,000,000 called for under the "limited 30 year fixed" proposal. In an effort to resolve what otherwise would have been a deal-breaking impasse, we agreed to communicate to the Board a settlement proposal calling for a compromise amount of $130,000,000 as the City's FYE 05 contribution, with all subsequent fiscal years covered by the settlement to require contribution of the full amount calculated by the actuary and approved by the Board for each such fiscal year.

Finally, because the settlement proposal *increased* the City's contributions over the following four fiscal years by an aggregate of approximately $75,000,000, we required that the City's annual employer contributions be secured by unencumbered real property for the term of the Settlement Agreement. The City agreed to this proposal, asking only that it have the right to substitute collateral during the term of the Settlement Agreement with other collateral of equal or greater value. Thus, the settlement negotiation process achieved the objectives of: (1) resolving all existing lawsuits against SDCERS; (2) invalidating any future enforcement of Manager's Proposals I and II; (3) increasing contributions to SDCERS over the following four fiscal years by an aggregate of approximately $75,000,000; (4) returning the retirement system to an actuarially based contribution method sooner than would have occurred under Manager's Proposal II; and (5) providing security for the City's substantially increased employer contributions during the critical first four years of the new contribution system.

G. Litigation Result Exceeding Settlement Value.

Fiduciary Counsel requested that we analyze the probability of a result achieved through litigation which conferred a greater benefit on SDCERS than is achieved through the pending settlement. It is important to note at the outset of this section that the settlement achieves substantially all of the most likely result which would come from a litigated resolution of this matter: (1) It substantially increases the amount of money contributed to SDCERS in the upcoming fiscal years, (2) it returns SDCERS to

an actuarially-based contribution method, and (3) it allows the Board to implement the most recent changes in actuarial assumptions significantly sooner than would otherwise be possible. Moreover, the foregoing benefits will be confirmed in the form of a judgment entered by the Court in the Consolidated Actions. The Court will retain continuing jurisdiction under Code of Civil Procedure section 664.6 for purposes of enforcing any term of the judgment against the City. (*See* Charter, Article I, sec. 1; *see also, Elyaoudayan v. Hoffman* (2003) 104 Cal.App.4th 1421, 1428.) Thus, the only means by which a litigated outcome could exceed the value of the negotiated resolution now pending before the Board would be a judgment for a substantial cash payment to SDCERS *in addition* to the foregoing benefits.

Under the circumstances presented by the *Gleason* litigation, there are three possible scenarios under which such a result might be achieved: (1) invalidation of Manager's Proposals I and II under Charter section 143 on a going-forward basis; (2) invalidation of Manager's Proposal II, with subsequent enforcement of the most financially favorable interpretation of Manager's Proposal I; or (3) an order directing the City to pay restitution to SDCERS in the amount of the "underfunding" caused by the three most recent years[29] of contract-based contributions.

1. Invalidation of Manager's Proposals I and II Under Section 143.

As discussed earlier in this letter, we consider it probable that the Court would grant Plaintiffs' Motion for Summary Adjudication, thereby invalidating both Manager's Proposal I and II on a prospective basis. In the event such a final judgment was entered in the *Gleason* litigation, the Board would thereafter be free to set whatever contribution rates it concluded were appropriate, based on its actuary's calculations and its evaluation of the appropriate financial burden to impose on the City. Under such circumstances, it is possible that the Board, based on advice from its actuary, would set contribution rates at a level higher than is provided for in the Settlement Agreement for the years covered by that agreement. Thus, it is possible that judicial invalidation of Manager's Proposals I and II could create a circumstance in which higher contribution levels could be set for some of the fiscal years covered under the Settlement Agreement.

The City would almost certainly appeal the trial court's ruling (the City's litigation counsel having stated as much on several occasions). Although we consider it

[29] Recovery of underfunding in earlier years would probably be barred by the three year statute of limitations governing Plaintiffs' claim. (*Abbott, supra*, 50 Cal.2d at 464.)

probable that the trial court's ruling would be upheld on appeal, the appellate process would delay entry of an enforceable judgment for a period of one to three years, depending on the City's willingness to pursue the issue to the highest appellate levels. In addition to the additional expense of litigating the issue on appeal, negotiations would almost certainly continue during the pendency of the appeal aimed at lessening the impact of the final judgment on the City's economic interests. Therefore, evaluation of the merit of this litigated solution must first be done in light of the near certain delay in implementing an economically superior contribution rate under authority of a final judgment.

Furthermore, in setting such a contribution rate, the Board would have to engage in an analysis of the City's financial condition similar to that already performed in the course of negotiating the Settlement Agreement. It cannot be overlooked that the Settlement Agreement sets a contribution rate for the City that results in an approximately $75,000,000 increase in employer contributions. This result was the product of negotiations with the City regarding its near term ability to pay increased contributions. Evaluation of whether the City could realistically meet its obligation for Fiscal Years 2005 through 2008 under an even higher contribution rate than is imposed by the Settlement Agreement must also be considered when analyzing the relative merit of the Settlement Agreement versus a litigation scenario.

Next, it is important to note that the City is required under the Settlement Agreement to provide collateral as security for the payment of the City's near term obligation to SDCERS. The collateral provides several benefits to SDCERS that would not be available under even the most optimistic litigation scenario:

- First, the proceeds from the sale (or sale/leaseback) of the collateral, of course, would provide additional sources to fund the City's obligations to avoid or cure a default event.

- Second, the liens on the collateral would preserve the priority of SDCERS to such proceeds against others creditors who might otherwise seek to obtain a lien on the collateral after the settlement.

- Third, the collateral provides additional rights to SDCERS in the event the City later seeks the protections afforded by Section 9 of the United States Bankruptcy Code.

Under the Bankruptcy Code, if SDCERS were only an unsecured creditor, the City would only be required to provide SDCERS with the same treatment under its plan for

the adjustment of the City's debts that the City provides to all other general unsecured creditors. Indeed, the City may not even be permitted by the Bankruptcy Court to separately classify or to solicit a separate vote from SDCERS on the plan of adjustment, and may be required to include SDCERS' vote with those of the City's general unsecured creditors. As a secured creditor, SDCERS would be separately classified in any plan of reorganization, would separately vote on the plan, and its secured claim could be treated differently than the claims of general unsecured creditors.

Moreover, as a secured creditor, SDCERS would be entitled to certain rights not generally available to unsecured creditors. SDCERS would be entitled: (a) to make a special election under 11 U.S.C. section 1111(b) to require, as a condition to the release of its lien in the collateral, that the entire obligation be paid in full, (b) to receive the value, as of the effective date of the plan, of at least the value of the collateral, and (c) to receive the "indubitable equivalent" of its claim. By contrast, the Bankruptcy Court has the power to confirm a bankruptcy plan of restructuring that does not provide for a minimum payment, or the payment in full, of claims of general unsecured creditors.

To guard against a subsequent administration's efforts to avoid paying an actuarially based contribution rate, we negotiated for - and obtained – $500,000,000 in new collateral as security for the term of the City's obligation under the Settlement Agreement. We concluded the fiscal years immediately following execution of the Settlement Agreement were most critical because the City would then be experiencing the greatest financial stress from the increased contribution levels. It is our expectation that the process of budgeting for increased contribution rates over the following four years will make the City less likely to react to the strain of further increases anticipated after the Settlement Agreement expires by attempting to avoid paying its full contribution amount. In crucial intervening years, the Settlement Agreement provides substantial security which would not be available under the first litigated scenario to protect against the same stresses that would be imposed by a judicially imposed increased contribution rate.

Finally, it should be noted that inclusion of $500,000,000 in collateral also addresses the "creditworthiness" issue raised in prior counsel's evaluation of Manager's Proposals I and II. The Settlement Agreement differs from Manager's Proposals I and II in two important - and determinative - respects. First, unlike Manager's Proposals I and II, the Settlement Agreement effects a substantial *increase* in the City's annual employer contribution amounts for the lifetime of the agreement. Second, the Settlement Agreement returns the City to actuarially based contribution rates, rather

than purporting to authorize a departure from this contribution method. Since the Settlement Agreement cannot be characterized as a "contribution relief" agreement, the theoretical basis for investigating the City's creditworthiness described in prior counsel's opinion letters is not present. Nonetheless, we recognized the significance of the issue given the financial strain imposed on the City by the Settlement Agreement's terms, and for that reason obtained security against its "default" in the form of $500,000,000 in real property as collateral to secure the City's contribution obligation over the lifetime of the agreement.

In light of the likely delay in implementing a different contribution rate under a court's judgment, and the uncertainty over whether such a contribution rate would significantly increase the City's employer contributions before fiscal year 2009, we consider the Settlement Agreement superior to the first possible litigated solution because of the immediacy of its terms, the amount of increased contributions which will be made thereunder, the return to an actuarially based contribution method, and the presence of substantial security during the critical first few years of substantially increased City contributions.

2. Selective Enforcement of Manager's Proposal I.

Another possible scenario in which SDCERS would receive a greater monetary recovery through litigation than through settlement requires a result in which the Court: (a) invalidates Manager's Proposal II, but leaves Manager's Proposal I in place, (b) rules that Manager's Proposal I is legally binding and enforceable, and (c) interprets Manager's Proposal I to obligate the City to make a one year payment of an amount sufficient to return the funded ratio to at least 82.3%, following which it would make contributions at the "contract rate" so long as the funded ratio remained above 82.3%. This scenario also requires some evidence that the City could pay such a judgment. For the following reasons, we view this as a highly improbable result.

It is technically possible for the Court to enter an order that invalidates Manager's Proposal II (via section 1090), but does not reach Manager's Proposal I (statute of limitations bar). However, it is important to recall our opinion that the probable result of this litigation is a decision by the Court, upheld on appeal, that both Manager's Proposal I and II violate Charter section 143, and are therefore unenforceable. As a result, we consider it unlikely that the Court would enter an order giving retrospective effect to Manager's Proposal I, because to do so would conflict with its conclusion that the agreement is unenforceable.

The improbability of this outcome is compounded by the fact the Court would have to not only find Manager's Proposal I enforceable, but also interpret it in a manner that

required the City to make a one-year payment sufficient to return the funded ratio to 82.3%. Moreover, this scenario would bear on the Board's comparative analysis of litigation versus settlement only if it was at least reasonably possible that the City could (and would) voluntarily pay such a judgment, rather than seek relief from either the gross amount, or the terms on which it was paid, from another court. The cumulative effect of the contingencies necessary to surpass the value of the proposed settlement makes the possibility of such a result remote.

3. Restitution By The City.

Plaintiffs have pleaded a claim for "restitution by the City of all amounts owed to the CERS' [sic] trust fund as a result of the City's past violations of law." In essence, Plaintiffs seek an award – to SDCERS – of the amount of underfunding resulting from contributions based on contract-based rates rather than the higher actuarially calculated rate. As mentioned above, the most probable outcome under this scenario would permit recovery of only the most recent three years of underfunding, due to the bar of the statute of limitations for earlier years. This amount is estimated to be between $90 million and $115 million.

We consider it probable that the Court will make the predicate finding to support Plaintiffs' restitutionary claim – that Manager's Proposal II violated Charter section 143. The question which would then be litigated would involve the proper amount of restitution to be paid by the City. Evidence (much of it technical and complex) would be presented as to the proper method of calculating the amount of past underfunding and the appropriate causal factors to be considered. While we consider it reasonably possible that the Court would ultimately enter an award of some amount of restitution, we cannot predict with any reasonable certainty what percentage of the current estimate would be awarded.

However, we can predict with some certainty that the City would appeal such a ruling, thus delaying payment for between 18 months and three years, during which further settlement negotiations would undoubtedly be conducted. Moreover, as we have warned in the past, a judgment of the size here at issue could prompt a future City administration to seek relief from the Bankruptcy Court, which would, at a minimum, delay, and possibly diminish SDCERS' ultimate recovery under this scenario. It is also important to consider, not only with this scenario but with all litigation scenarios, that SDCERS will continue to incur fees, costs and associated expenses in its effort to achieve a superior result through litigation than is available through the settlement under consideration. Although we have not undertaken a detailed fee and cost estimate as to the scenarios discussed herein, based on our experience with cases of similar scope and complexity, it is reasonable to estimate that litigation of this action to

completion – without regard to the possibility of achieving a superior result to settlement – would cost SDCERS between $300,000 and $500,000 in *additional* fees and costs.

CONCLUSION

The analysis set forth in this letter demonstrates the difficulty of predicting any outcome, let alone a superior outcome, with any reasonable degree of certainty. In summary, it is our opinion that a possibility exists of obtaining a marginally superior monetary outcome compared to the settlement pending before the Board. However, that outcome would involve a delay of at least eighteen months, and more likely closer to three years, before final resolution, at an additional cost to SDCERS of between $300,000 and $500,000. In our opinion, the immediacy, certainty, monetary value, and return of normal fiduciary powers to the Board of the pending settlement proposal, make it a superior resolution of the *Gleason* litigation than any reasonably foreseeable litigated result.

Very truly yours,

Michael A. Leone
SELTZER CAPLAN McMAHON VITEK
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MAL:km/ejg

EXHIBIT No. 47

Report on Investigation

The City of San Diego, California's

Disclosures of Obligation to Fund the

San Diego City Employees' Retirement System

and Related Disclosure Practices

1996-2004

with

Recommended Procedures and Changes to the Municipal Code

September 16, 2004

Paul S. Maco
Richard C. Sauer
Vinson & Elkins L.L.P.
Washington, D.C.

> On January 16, 2003, a class action complaint (*Gleason v. City of San Diego, et al.*) for declaratory relief was filed in the Superior Court against the City, the City's Employee's Retirement System (SDCERS), and certain named members of the SDCERS board of administration. The plaintiffs, former City employees who receive City retirement benefits, allege that as a result of recent actions taken by the defendants, the SDCERS trust fund has an unfunded accrued liability of $720 million, and that by 2009, the City will owe approximately $2.8 billion to SDCERS, with an annual City budget expense of more than $250 million. In addition to the declaration of their rights, plaintiffs ask for restitution to the SDCERS trust fund, an injunction prohibiting the City from unlawfully underfunding the trust fund in the future, money damages, attorney' fees, and other relief. [299]

SDCERS and the City litigated the matter for over a year, then, in August 2004, entered into a settlement with the plaintiff class on terms that bolstered the financial stability of the System. The settlement essentially obviated any future operation of the Manager's proposals, providing among other things:

- The City shall pay the full ARC (calculated under the PUC method) beginning FY 2006;[300]
- The City shall pay $130 million for its FY 2005 contribution to the system; and
- The City shall provide a total of $500 million in security interests in real property to secure its required contributions to SDCERS through FY 2008. The security interests will be released in the amount of $125 million annually through FY 2008 as the required contributions are made.

The agreement further provides that the amortization of the System's UAAL will be reset at June 30, 2004, based on a new 30 year period. However, after FY 2008, the City, absent an amendment to the City Charter, must contribute to SDCERS at the rates calculated by the SDCERS actuary and approved by the SDCERS Board. This may involve changed actuarial assumptions or yet another, and potentially shorter, amortization period.[301] A shorter amortization period would, at least initially, act to increase the City's contribution rate.

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[299] *See, e.g., Official Statement, City of San Diego/MTDB Authority, 2003 Lease Revenue Refunding Bonds*, April 30, 2003, at A-38.

[300] Accordingly, the City agreed to repeal the provisions of Municipal Code ch. 2, art. 4, div. 2, § 24.0801 that conformed the City's contribution obligations to the payment schedule contained in MP2.

[301] We understand that a rolling 15-year amortization period is contemplated. A rolling amortization period, which is acceptable under GASB standards, results in the employer paying a set fraction (here 1/15) of the UAAL every year. Thus the UAAL is never extinguished, unless as a result of factors other than the amortization mechanism.