WILLKIE FARR & GALLAGHER LLP **MEMORANDUM**

TO: Files

CC: San Diego Audit Committee

FROM: Willkie Farr & Gallagher LLP

RE: Interview of Scott Peters on May 1, 2006

DATED: May 24, 2006

On Monday, May 1, 2006, Benito Romano, in Willkie Farr & Gallagher LLP's ("Willkie") capacity as counsel to the Audit Committee, interviewed Scott Peters. Councilmember Peters was represented by counsel, Pamela Naughton and Rebecca Shults of Sheppard, Mullin, Richter & Hampton LLP. Also in attendance were Troy Dahlberg of the Audit Committee, William Haegele of KPMG, and Brian Faerstein of Willkie. The interview took place in a conference room in the offices of Sheppard, Mullin, Richter & Hampton LLP in Del Mar Heights, California and lasted approximately three and one-half hours.

The following memorandum reflects my thoughts, impressions, and opinions regarding our meeting with Scott Peters, and constitutes protected attorney work product. It is not, nor is it intended to be, a substantially verbatim record of the interview.

Warnings

Mr. Romano began the interview by explaining the circumstances and purpose of the City of San Diego's (the "City") creation of the Audit Committee, noting that information obtained during the course of the interview would be used, if relevant, in our analysis of the issues and would be reflected in an Audit Committee report. Mr. Romano explained Willkie does not represent Councilmember Peters, but we would be treating matters discussed during the interview as confidential until the release of the Audit Committee's report, after which it seems likely that any privilege attaching to our interview memoranda will be lost. Mr. Romano stated that because we do not represent Councilmember Peters, the interview is not covered by an attorney-client privilege between the Audit Committee and Councilmember Peters. Mr. Romano however asked Councilmember Peters to keep the interview confidential. Mr. Romano further explained that, if requested, we would provide information we learn to the SEC, the U.S. Attorney's Office or the City's outside auditor, KPMG, so it is important that Councilmember Peters be accurate and truthful. Mr. Romano emphasized that Councilmember Peters should feel free to seek clarification of any question at any time.

Background

Before being elected to City Council, Councilmember Peters worked as a lawyer for fifteen years. He started practicing as a corporate lawyer at a large law firm in Minneapolis, Minnesota. After one year, he decided to switch to the environmental regulatory division at the

same firm and came to enjoy environmental law. In 1989, he moved to San Diego with his wife and joined Baker & McKenzie, working in the general litigation department. He left Baker & McKenzie to become the San Diego Deputy County Counsel. He served in that position for five years, handling a number of environment and land use issues, including nuisance cases, spills, and land development. Councilmember Peters left that position in 1996 and opened up his own law firm, Peters & Varco LLP. However, he had known since 1996 that he wanted to serve on San Diego City Council, and he was successful in 2000, earning election as the Council representative for District 1.

Mr. Romano asked Councilmember Peters if the pension fund was an issue during his 2000 campaign. Councilmember Peters responded that it was not much of an issue, as the campaign focused primarily on the Ballpark project and ethics concerns arising out of the Valerie Stallings bribery scandal. Also, in Councilmember Peters's district, clean water was a very significant issue because of a number of high profile sewer spills in the region in the years leading up to the election. Councilmember Peters noted that he also campaigned for a strong Mayor form of government, but that this issue was not very prominent because it did not gain much traction. Nonetheless, he had been working to amend the City Charter since the 1990's to implement that form of government.

Councilmember Peters took office the first week of December 2000. Asked whether he received formal training regarding the duties of Council members, Councilmember Peters explained that the new members of Council went through a three-day orientation program, but that it was more of a mechanical exercise in which members of each City department and office would introduce themselves and explain the basic function of that governmental unit. Councilmember Peters could not recall whether any pension fund issues were discussed during this orientation.

When Councilmember Peters first took office, he served on the Natural Resources and Culture Committee and the Land Use Committee. The Natural Resources and Culture Committee dealt with parks, library, sewer and water issues. Councilmember Peters did not think that this committee handled sewer rate issues, as he believed that these issues went straight to the full City Council. Rather, this committee mostly dealt with the policy and contract issues related to various park, sewer and water projects.

Councilmember Peters currently serves on the Rules Committee, a position he assumed in 2003 when he became chairman of the Land Use Committee. Councilmember Peters is also the co-chairman of the Clean Water Task Force, a role Mayor Dick Murphy asked him to fill, and serves on the Metropolitan Transit Board.

Budget Process

Mr. Romano asked Councilmember Peters about how the budget process generally operates. Councilmember Peters explained that, when he first took office, he believed the process operated in a somewhat "secret" fashion. The City Manager would meet with City department heads to discuss certain funding issues and then come before City Council in or around February or March. The City Manager prepared a first draft of the budget by that time. Councilmember Peters explained that the City Manager would give Council an introduction as to the structure of the budget and what amount each District would be receiving. Councilmember

Peters noted that in his first year in office, there was some money left over for the Districts and Mayor Murphy asked each Council member how would propose to use these excess funds.

Councilmember Peters explained that, at some point, the City Manager had to issue the budget and hand it over to Council to work through in budget hearings. Asked what there was to work through, Councilmember Peters stated that, "you were at a disadvantage in terms of arguing with it because [the City Manager] had all the information." Councilmember Peters pointed out that, with some departments, Council simply did not argue about how much the department would be getting and how it should be using its funding. For example, the Council would usually just defer to Scott Tulloch, Director of the Metropolitan Wastewater Department ("MWWD"), as he was perceived as being best equipped to decide how to manage the MWWD's spending. Most of the funding battles came over the Park and Recreation Department.

Councilmember Peters explained that Council's difficulty in obtaining relevant information derives from a provision in the City Charter which restricts Council members' ability to argue with the City Manager -- or go outside the scope of his authority -- as to address certain budget items. Councilmember Peters has suggested the idea to Council to create ad hoc committees to look at the budget of certain departments over the course of the year as a way to get around this limitation, but this idea has so far not been implemented. Councilmember Peters clarified that the bulk of the budget hearings occur in April and May before the budget and appropriations ordinances had to be adopted by the end of June. He described this part of the process as "fighting at the margins of the process," a reality he believes supports his position that ad hoc committees should be examining budget issues throughout the year. Councilmember Peters explained that Mayor Murphy tried to improve the communication aspect of the process by working with Council members to collect their priorities and serve as a liaison to the City Manager to suggest amendments to the budget.

Mr. Romano asked Councilmember Peters about how long-term encumbrances, contracts or projects would be factored into the annual budget. Councilmember Peters stated that Michael Uberuaga and Lamont Ewell (both former City Managers) would approach this issue very differently. With regard to Uberuaga, Councilmember Peters first noted that he was surprised that Mayor Murphy had reappointed him as City Manager, as Uberuaga was generally perceived as a Mayor Susan Golding person. Councilmember Peters believed that Uberuaga was overmatched in the position, as he had come to San Diego after serving as City Manager of Huntington Beach, California, a much smaller city. Councilmember Peters recalled that he, Councilmember Brian Maienschein, Councilmember Toni Atkins, and possibly Councilmember Jim Madaffer wanted to get rid of Uberuaga, but they did not openly express this sentiment because of the potential political and policy-oriented ramifications (*i.e.*, Uberuaga would favor the other Council members' Districts).

Councilmember Peters explained that, unlike Uberuaga, Ewell mandated that a five-year forecast be conducted in connection with the structuring of the budget. Ewell had a much more long-term perspective than Uberuaga, as Uberuaga would only make projections for major projects such as the ballpark or the library. Some Council members had discussed two-year budgeting during Uberuaga's tenure, but the long-term component to the budget process did not come until Ewell took over as City Manager.

Mr. Dahlberg asked Councilmember Peters whether he perceived Uberuaga as a mere filter to City officials such as Ed Ryan (City Auditor & Comptroller) and Mary Vattimo (City Treasurer). Councilmember Peters responded that he did not think that Uberuaga was at all competent and mostly delegated matters out to other City departments and offices. Mr. Dahlberg asked Councilmember Peters about his perception of Jack McGrory (former City Manager). Councilmember Peters believed McGrory was effective but that he tended to do things outside of Council's sphere. Councilmember Peters recalled that McGrory had once told him that he did not tell Council members where all the money was because he believed they would just go out and spend it.

Mr. Romano asked Councilmember Peters about where and when information about the City's contribution to the pension fund would come up during the budget process. Councilmember Peters stated that the City's contribution "wouldn't have gotten a lot of attention in the budget process" during his early years as a Council member. He explained that there was likely a section in the budget about the Retirement System and what the San Diego City Employees' Retirement System ("SDCERS") Board actuary does. He speculated that there might have been a discussion about MP1 within that section. However, he explained that there was not a separate oral report about pension issues as there was for matters like the Ballpark, library, streets, trash and other more everyday, conspicuous issues. Councilmember Peters believed that the SDCERS fund probably did not get a lot of attention until the 2003 budget process after potential problems with the Retirement System became more apparent during 2002.

Mr. Romano later asked Councilmember Peters whether, during years in which Meet-and-Confer took place during the spring, the results of the labor negotiations had to be determined before the budget was finalized. Councilmember Peters explained that the negotiated salaries and benefits had to be determined and incorporated into the budget for that year. Mr. Romano asked Councilmember Peters whether Council members were informed about how the benefits granted during Meet-and-Confer would affect the overall pension obligation. Councilmember Peters explained that the general concept was explained (*i.e.*, the effect on the pension liability if payments are stated as salary increases or as pension benefits), but the actual numbers were not specified.

Blue Ribbon Committee

Mr. Romano asked Councilmember Peters whether Mayor Murphy had discussed the creation of the Blue Ribbon Committee ("BRC") with him in advance. Councilmember Peters stated that he did not, as he hardly knew the Mayor at that point in 2001 and, further, that Peters had supported the Mayor's opponent in the election (Ron Roberts). Asked whether the BRC was discussed with Council or unilaterally created by the Mayor, Councilmember Peters believed that it would have been something that most of the Council members would have welcomed, as many were newly-elected and it seemed like a good idea to get a fresh start in office.

Mr. Romano asked Councilmember Peters whether, in creating the BRC, there was a sense that the Mayor and Council were having trouble obtaining relevant information about potential City issues or that there were actual problems that needed to be addressed. Councilmember Peters explained that one general campaign issue during 2000 was that the

City's infrastructure was crumbling. In response to Councilmember Atkins's position that the City needed to raise taxes, the Mayor and Council believed the BRC would be a good way to look at the infrastructure issue in particular and come up with some recommendations for action. Mr. Romano asked how the pension issue became part of the BRC report. Councilmember Peters was not certain, but he believed that either the BRC members thought of the issue themselves or Mayor Murphy had included it in a list of general issues to examine.

Mr. Romano asked Councilmember Peters whether he was involved in the BRC investigation. Councilmember Peters explained that the BRC operated on its own and did not report periodically to Council. He could not recall whether BRC members or staff reported informally to the City Manager or members of Council, but noted that the Mayor may have had some contact with the BRC because it was "his" committee. Mr. Romano inquired whether Councilmember Peters recalled a sense during the investigation that the course that the BRC was taking could harm the City's bond ratings. Councilmember Peters could not recall but believed he would have wanted the BRC to report candidly about what it really perceived the City's financial health to be. Councilmember Peters did not know whether Mayor Murphy kept a close ear to the process but noted that the Mayor "picked people [to be on the BRC] who we expected to bust us." He speculated that, among the Mayor's staff, he would have expected Bill Baber (Rules Committee Consultant) or John Kern (Chief of Staff) to be most involved in overseeing the process.

Mr. Romano asked Councilmember Peters about his recollection of the February 27, 2002 Rules Committee meeting at which the BRC made a presentation. Councilmember Peters recalled hearing about this presentation at the time, specifically in relation to the discussion of the Point Loma outfall and the deferred maintenance issues. Councilmember Peters recalled hearing that the pension fund contribution deficit was $6-$8 million, "so at that point it would not have raised that big of a concern." Mr. Romano inquired about the background of the Point Loma issue. Councilmember Peters explained that San Diego was one of only two cities that did not conduct secondary treatment of sewage before releasing it to the ocean and had to obtain waivers to take that approach. The BRC addressed problems in connection with this waiver issue.

Mr. Romano inquired whether Councilmember Peters was aware that, after the BRC made its recommendations to the Rules Committee and released its report, there were some concerns about the potential "spin" of the Report. Councilmember Peters stated that he was not aware of this issue at the time. Sensing that Mr. Romano was referring in particular to Richard Vortmann, who had served on the BRC, Councilmember Peters noted that Vortmann had voted to approve MP2, so he "sends a mixed message." Mr. Romano continued the chronology of events, explaining that the BRC recommendations regarding the pension fund issue were referred to the SDCERS Board to be examined. Councilmember Peters explained that he understood that referral now but he was not necessarily aware of that approach at the time. Mr. Romano asked Councilmember Peters whether he recalled the rationale for having the SDCERS Board take on this funding deficit issue rather than the City Manager or City Council. Councilmember Peters speculated that they probably believed that the SDCERS Board best understood the complex issues underlying the pension system.

Explaining that by the time of the SDCERS Board's February 12, 2003 presentation to the Rules Committee, the funding ratio had decreased dramatically, Mr. Romano asked Councilmember Peters whether he recalled any concerns at the time about the Retirement System. Councilmember Peters recalled that this was around the time the pension problems began showing up prominently in the media. He speculated that the letters Diann Shipione had written about the pension system in November and December 2002 probably helped get the pension issue on the Rules Committee docket sooner.

Mr. Romano inquired why people did not understand the gravity of the issue sooner than February 2003. Councilmember Peters proffered a number of reasons for the slow response. First, he explained that $6-$8 million was not perceived to be a significant amount of money, particularly in comparison to other issues raised by the BRC. He believed that people did not think the problem could so quickly get out of hand. Second, Council members received a lot of information during 2002 and 2003, very often in informal settings, from City officials who would play down the seriousness of the pension funding issue and Shipione's allegations. In particular, Ryan, Frederick Pierce (SDCERS Board President), Lawrence Grissom (SDCERS Board Administrator) and Terri Webster (Assistant City Auditor & Comptroller) were usually available to talk after meetings and offer a calming approach. Councilmember Peters recalled Grissom providing him with the general notion that the pension problem would go away at any point if the City just paid the actuarial bill for thirty years. Third, Councilmember Peters explained that the issue was so complicated -- particularly with regard to the dichotomy between the PUC and the EAN funding methods -- that it was difficult to question the information and advice of officials who were in a position to know the complexities. Councilmember Peters generally deferred to and trusted those people.

Mr. Dahlberg asked Councilmember Peters whether there was any sense that there might be potential conflicts of interest among members of the SDCERS Board. Councilmember Peters explained that Council would have expected the SDCERS Board members to have been the ones to deliver the worst story, so when people such as Pierce and Grissom were so reassuring, it gave Council members a reason to trust their judgment. Mr. Romano asked whether Councilmember Peters perceived potential problems with the waterfall and the use of surplus earnings. Councilmember Peters explained that contingent benefits were portrayed as truly conditional and only paid when there was in fact "extra money."

Mr. Romano read from an April 5, 2002 article in the San Diego Union-Tribune entitled, "Pension Fund Lost Millions Last Year" (Exhibit 1). Mr. Romano read a statement by Grissom in the article: "If we never made another dime in income, we would be able to pay retirement benefits for the next 26 years. They (retirees) have no worry." Councilmember Peters explained that he understood this to mean that the pension fund as it stood at the time would have had enough money to pay for the retirement benefits of all present employees for 26 years. Councilmember Peters would have perceived this statement at the time to mean that they had a certain amount of time to "work their way out of it." Mr. Romano asked Councilmember Peters about what options they considered in 2003. Councilmember Peters explained that Ryan did not like the idea of issuing Pension Obligation Bonds because, as far as Councilmember Peters understood Ryan's reasoning, the bonds changed "soft" debt into "hard" debt. Councilmember Peters believed that by "soft," Ryan meant the debt could more easily be ignored, as it was not owed to a bank but rather only to the pension fund. Councilmember Peters

recalled that there were several other options considered in 2003, including gradually raising the City's contribution rates and making contributions in order to hold the funding level status quo for that particular period of time.

Pension Reform Committee

Mr. Romano asked whether Council was involved in the decision to create the Pension Reform Committee ("PRC") in mid-2003. Councilmember Peters explained that it was Murphy's style to create this type of working group, but that Council was behind the idea because most Council members believed the pension fund issue needed to be studied further. Mr. Romano briefly recounted the series of studies that had been performed by that point in time, including the BRC Report in February 2002, the SDCERS Board's presentation in February 2003 and the City Manager's pending report in June 2003. Mr. Romano inquired about why the Mayor and Council requested yet another study when the City Manager was close to completing his own report. Councilmember Peters recalled that they believed the PRC was necessary because "they could not get the right information from anyone about the right thing to do." He explained that there was no institutional process within City government to craft an idea or share the necessary information. Asked who he was referring to within City government, Councilmember Peters stated Grissom, Pat Frazier (Deputy City Manager), Ryan, Webster and Vattimo. He believed these officials were dismissive about the need to immediately address the pension issue. Councilmember Peters stated that, overall, the "mantra" within City government was that Diann Shipione was crazy and mad at the Mayor and that people should not worry about the pension fund. Thus, Councilmember Peters believed that an outside group of individuals was needed to examine the problem, as the Council otherwise had to rely on those dismissing the problem. He believed that the PRC recommendations were overall on point, noting that Council adopted a number of them.

Mr. Romano later showed Councilmember Peters two draft reports from the City Manager, each dated "June __, 2003," and apparently neither of which was released (Exhibits 2 and 3). Mr. Romano asked Councilmember Peters whether he ever had the sense that the creation of the PRC shut down the City Manager from addressing the pension issue. Councilmember Peters could not recall having this understanding, but speculated that Uberuaga would have wanted to hand the issue over to the PRC -- or to the Mayor and City Council -- and not have much ownership of it. Asked whether he recalled discussion about the City Manager coming up with his own approach to the problem, Councilmember Peters did not but believed that Council likely believed that the City Manager was less competent to deal with the problem than an outside group of experts. Councilmember Peters could not recall ever receiving Uberuaga's draft reports but believed anything Council received from the City Manager's Office at that point in time would have lacked credibility and been "pretty useless." Councilmember Peters believed that Uberuaga relied primarily on Ryan and Grissom for his information and, moreover, for his own general perception. Councilmember Peters noted that Uberuaga and Grissom would have never played down the significance of the pension problem in public reports, but rather would have provided reassurance through informal channels and contacts. Councilmember Peters saw these officials -- and Les Girard (Deputy City Attorney) -- weekly at both open and closed session meetings and they would all provide reassurances on a steady basis.

Mr. Romano showed Councilmember Peters the City of San Diego Pension Reform Committee Final Report, dated September 15, 2004, and R.H. Vortmann's Minority Report, dated September 15, 2004 (Exhibits 4 and 5, respectively). Asked what he believed was the root of the pension fund problem prior to the release of these reports, Councilmember Peters recalled being told that 80-85% of the deficit derived from stock market losses. Mr. Romano asked whether, after reading these reports, he began to question the veracity of City officials and SDCERS Board members. Councilmember Peters recalled speaking with Pierce after the release of the reports and Pierce still believed that if the stock market had not crashed, the City would not have had the pension problem on its hands. Councilmember Peters generally believed that Pierce was competent and that his opinion was just a different perspective, not necessarily a falsehood. Councilmember Peters did not believe that anyone actually thought that market losses were the only problem; rather, he believed that many people just did not take the other parts of the problem very seriously.

Mr. Romano asked Councilmember Peters whether he ever spoke with Grissom about the PRC Report. Councilmember Peters could not recall when he spoke with Grissom, but remembered having a series of conversations with him about how to approach the pension fund issue after February 2003. Grissom told Councilmember Peters that the pension problem would work itself out over time, particularly considering the SDCERS' investment portfolio was stronger than many other comparable government's retirement plans.

Mr. Dahlberg asked Councilmember Peters why he believed Mayor Murphy liked to create committees. Councilmember Peters explained that the Mayor was very deliberative and sought to acquire all available and relevant information before he made a decision. Councilmember Peters speculated this trait likely carried over from Mayor Murphy's previous career as a judge. With regard to the PRC, Councilmember Peters believed that the public likely had reason to doubt the City's handling of the pension issue because of all the negative media in 2003. Thus, the creation of an outside committee was a way to build credibility as to the City's short-term and long-term approaches to the problem. Noting that Vortmann had emphasized the urgency of the problem as far back as the February 27, 2002 Rules Committee meeting at which the BRC made its presentation, Mr. Romano asked Councilmember Peters whether the creation of the PRC could have created a different public impression, namely that the problem was again not being addressed promptly. Councilmember Peters believed that people were still confused as to whether there was a problem even at the time of the PRC's creation.

Labor Negotiations and MP2

Mr. Romano asked Councilmember Peters when he recalled first hearing about MP1 or "corridor funding." Councilmember Peters believed he probably came to understand these topics when he first heard about the funding ratio dropping around the time of the February 2003 Rules Committee meeting. Mr. Romano explained that at the time of the BRC's presentation in February 2002, the funding ratio used in the BRC Report was stale (97.4% instead of the previously released 88.9%) and that, by the time of the February 2003 Rules Committee meeting, the funding ratio had dropped to 77.4%. Councilmember Peters was somewhat confused by the timeline, stating that at the time he heard about the low funding ratio, the "trigger had been hit, or was going to be hit." Asked when he first learned about the MP1 trigger, Councilmember Peters stated that Council members were informed about how the trigger

provision worked in a closed session meeting and that they were made aware of the proposal to extend the payment over five years.

Mr. Romano showed Councilmember Peters an April 26, 2002 Closed Session Agenda regarding Meet-and-Confer issues (Exhibit 6). Mr. Romano inquired whether this closed session meeting was the one about which Councilmember Peters was referring. Councilmember Peters said that it probably was and that Council would not have learned about the trigger before this point in time. He recalled that either Ryan or Webster was involved in explaining the background of MP1 and the trigger. Councilmember Peters believed that someone asked a question about the financial impact if the trigger were to be hit, and they were told at that time that the cost to the City would be around $20 million.

Mr. Romano asked Councilmember Peters whether he recalled the proposal for contribution relief and the Meet-and-Confer benefits being discussed at the same time. Councilmember Peters did remember this but, because he and the other newly-elected Council members from 2000 were working through labor negotiation issues for the first time, it did not seem so out of the ordinary that the issues would be addressed together. He recalled that the discussion of the labor benefits involved calculations about what the City could afford and the timing of the payment schedule (with discussion of MP1 arising in the context of the latter issue). Mr. Romano inquired about whether there was a sense of "trading off" during this meeting. Councilmember Peters stated that this was not much of an issue, as there was general consensus among Council members to give the labor unions raises in terms of benefits. This sentiment derived from the recognition of the heroism of firefighters and police officers after the events of 9/11 and the understanding that they were not being compensated as fairly as they should have been. Asked whether there were any dissenters from this view, Councilmember Peters noted that Mayor Murphy was somewhat more conservative about raising benefits, as were a few other members of Council. However, the major labor deliberation at the time was the "union shop" issue, namely whether the MEA could provide benefits to City employees who were not members of the union.

Mr. Romano later inquired about how labor unions lobbied Council members during Meet-and-Confer. Councilmember Peters recalled that Mayor Murphy stated that the labor negotiating team should not be in frequent contact with City Council. Both he and the Mayor were concerned about leaks regarding how the negotiations were proceeding, so Council made it a misdemeanor to leak that information. Council would hear from the labor negotiators about general policy issues (*e.g.*, City firefighters are ranked eighth in California in terms of level of benefits). Asked whether he spoke with individual union representatives, Councilmember Peters recalled that he spoke with Ron Saathoff (Firefighters' Union) and Bill Farrar (Police Officers' Association) about general levels of compensation, but they did not discuss specific negotiations. Councilmember Peters later noted that he recalled having conversations with union representatives in general (and not specifically Saathoff) about how much they did not like Cathy Lexin (Human Resources Director), mostly because of the way she communicated with them.

Mr. Romano asked Councilmember Peters about how the unions would turn up the pressure about a particular issue. Councilmember Peters provided an example from the 2005 Meet-and-Confer negotiations, during which the police officers did not get all the benefits they

wanted. A crowd of them showed up at a later open session meeting, dressed in full uniform and making threats such as that they would not work during a particular big event. However, the City mostly deals with one or two representatives from each union during the labor negotiations period.

Mr. Romano explained that, during the labor negotiation time period, the Rules Committee -- and, likely, Council -- had just received information from the BRC that the pension system was not being fully-funded. Mr. Romano asked Councilmember Peters whether this fact came up during the discussion of granting enhanced pension benefits. Councilmember Peters could not recall such a discussion. Mr. Romano inquired whether this could have been because Council members believed that the pension funding issue was on the Rules Committee "track" and not directly related to Meet-and-Confer issues. Councilmember Peters believed that the lack of discussion about the issue derived mostly from the reassurance Council members received about the long-term solutions to the pension funding issue.

Mr. Romano inquired whether Council's learning about the trigger at that point had any impact on its approach in increasing benefits. Councilmember Peters explained that they believed that MP2 was a "way to solve the problem." Based on what he heard from City staff, he perceived the contribution relief proposal as linked to the benefits discussion in that the City would not be able to support the increased benefits unless it got the requested contribution relief. Asked whether there was a sense of contingency between the benefits and the contribution relief, Councilmember Peters stated, "that was the strategy of the team, I think." Councilmember Peters clarified, "by the way, it did not end up being contingent." He believed this to be the case because the benefits were ultimately granted months before MP2 was approved and he referenced Councilmember Byron Wear's email as evidence of this fact. Mr. Romano showed Councilmember Peters a June 23, 2002 email from Councilmember Wear to Lexin, the Mayor, Council members, and a number of City officials -- Casey Gwinn (City Attorney), Elmer Heap (Head Deputy City Attorney), Leslie Devaney (Deputy City Attorney), Girard, Uberuaga and Ewell (Exhibit 7). Councilmember Peters explained Councilmember Wear's concern, namely that the Memoranda of Understanding entered into with the labor unions would have been enforceable regardless of the result of the November vote on MP2. Thus, Councilmember Peters believed the issues were separate at that point.

Mr. Romano asked Councilmember Peters whether he was aware of the original MP1 modification proposal that would have lowered the trigger to 75%. Councilmember Peters recalled hearing about it. Asked whether anyone raised concerns that this funding floor could be a problem, Councilmember Peters recalled that no one did because Council was continually told that the SDCERS Board had its own independent counsel who advised on those types of issues and thus Council believed the Board had all the necessary information.

Mr. Romano showed Councilmember Peters a July 8, 2002 memorandum from Lexin and Heap to the Mayor and City Council regarding contingent retirement benefits and the modification of the pending Manager's Proposal (Exhibit 8). Mr. Romano directed Councilmember Peters's attention to the language on page 2 regarding Lexin and Heap being "optimistic" about a favorable report from the SDCERS Administrator (with regard to the modified proposal) and their anticipation of a SDCERS Board member making a motion to approve the modified proposal. Mr. Romano asked Councilmember Peters whether it was

viewed as normal for City staff to inform City Council about the activities and discussions taking place within the SDCERS Board. Councilmember Peters explained that this situation was a "once in my experience kind of thing." Asked whether Council members were concerned about SDCERS Board members wearing more than one "hat," Councilmember Peters believed that they did discuss this issue as a general matter, noting that he believed they discussed it in closed session with regard to Saathoff's Presidential Leave benefit. Nonetheless, he explained that they thought that the SDCERS outside fiduciary counsel would have addressed these types of issues and that "it looked like he was doing his job."

Mr. Romano later asked Councilmember Peters whether he or anyone else was aware who Lexin and Heap were referring to on page 2 of their memorandum with regard to a Board member making a motion to modify the initial proposal. Councilmember Peters explained that he tended to give memoranda prepared for closed session meetings (such as this one) less attention than others because he received them on Fridays at which time he was usually out of the office seeing constituents or playing golf. He would not usually receive these types of memoranda until Mondays. Noting the "inside" nature of the information about the SDCERS meeting, Mr. Romano asked whether this piqued his interest about the matter at all. Councilmember Peters explained that Lexin was in the position of conversing with all of the union presidents, so it would not have been out of the ordinary for her to have this type of information. Councilmember Peters did not believe that anyone asked to whom Lexin was referring. Councilmember Peters reiterated that this would not have appeared peculiar to him because Meet-and-Confer issues and proceedings were new to him.

Mr. Dahlberg asked Councilmember Peters whether there was always someone from the City Attorney's Office present at closed session meetings. Councilmember Peters answered that there was, noting that Gwinn attended most closed session meetings. For retirement benefit-related issues, Girard and Devaney would usually attend, and Heap and Michael Rivo would also usually show up for Meet-and-Confer discussions. Mr. Dahlberg asked Councilmember Peters whether he believed at the time that these City staff members monitored and understood the issues of legality underlying the proposals. Councilmember Peters said that he believed these individuals seemed to have thought things through and usually had answers to Council members' questions. Mr. Dahlberg asked whether any of these staff members ever expressed any major legal concerns. Councilmember Peters responded that they mostly did not. He recalled that a Council member asked about the reason for the SDCERS Board indemnification resolution that accompanied MP2, and Girard explained to Council that this provision was perfectly valid. Councilmember Peters asked Girard about this issue informally after a meeting and Girard reassured him that it was not a concern. Councilmember Peters remembered speaking generally with Girard at some point about potential concerns with people negotiating their own benefits, and Girard answered his questions and soothed any potential concerns.

Mr. Romano showed Councilmember Peters the minutes from the November 18, 2002 City Council meeting at which the MP2 ordinance and the indemnification resolution were approved (Exhibit 9). Mr. Romano asked Councilmember Peters if he recalled a discussion at this meeting about the rationale for granting the indemnification provision to SDCERS. In particular, Mr. Romano inquired about whether there was a sense that the SDCERS Board would be exposed to potential liability and, further, why this provision was needed at that specific point

in time. Councilmember Peters could not recall any such discussion. Mr. Romano asked whether it may have just been understood that the SDCERS Board's approval of MP2 was fundamentally at odds with the interests of the SDCERS plan participants. Councilmember Peters explained that he would have to look back at a staff report for answers to Mr. Romano's inquiries. He speculated that the report would likely state that the SDCERS Board members felt uncomfortable in general because of their role as volunteers and Council believed granting the provision was the right thing to do. Councilmember Peters believed that it probably was not considered a big issue at that time, as the Government Code provided a means for passing such indemnification provisions if appropriate findings were made.

Shipione Allegations

Mr. Romano asked Councilmember Peters whether he recalled Diann Shipione (SDCERS Board member) attending the November 18, 2002 City Council meeting. Councilmember Peters stated he did, noting that he had pulled the proposal off of the consent agenda and requested that it be discussed. Councilmember Peters remembered her being rather agitated and calling the proposal "corrupt," which he thought was pretty bold at the time. Mr. Romano asked whether Councilmember Peters knew Shipione before the meeting. Councilmember Peters said that he had met her through her husband, Pat Shea, whom Councilmember Peters had come across during his career as a lawyer. Asked his impression of Shipione before she spoke at the meeting, Councilmember Peters believed she was attractive and intelligent, noting that he knew she was a stock broker.

Mr. Romano asked Councilmember Peters about why Shipione's allegations were dismissed. Councilmember Peters explained that she was in the minority of the SDCERS Board, as the only other dissenting vote was the Board's POA Representative (Tom Rhodes) who was generally upset with how the benefits had been negotiated during Meet-and-Confer. Councilmember Peters stated that she did not have an "effective personality" and she was "apparently not a very likable person," such that her personality "preceded the substance of her allegations." Councilmember Murphy also explained that Shipione was associated with her husband's effort to challenge Mayor Murphy because of the Mayor's earlier veto of a Brownfields project with which Shea was heavily involved. Councilmember Peters later pointed out that he and other members of Council may have believed that her credibility was undercut by her strident claims that dead pensioners were being paid when in fact that was not a serious problem.

Mr. Romano showed Councilmember Peters a December 6, 2002 memorandum from Ewell to the Mayor and City Council responding to Shipione's allegations (Exhibit 10). Mr. Romano asked whether Councilmember Peters recalled seeing this memorandum and Shipione's earlier letter, which Councilmember Peters did. Asked whether Council discussed Ewell's report, Councilmember Peters believed there was only informal talk about it. The general reaction was that Ewell was a credible person, his response seemed to answer Shipione's concerns, and the Council was already discussing ways to fix SDCERS. Noting how specific Shipione's allegations were, Mr. Romano asked whether there was a sense that no one wanted to deal with such a meticulous analysis. Councilmember Peters explained that he would not have engaged in a point-by-point analysis of her allegations, in particular with regard to complex issues such as the PUC versus EAN funding method debate. Councilmember Peters stated that,

overall, the City Manager's Office had made a decent effort to respond and that is what Council had asked for. Asked whether he discussed Shipione's allegations with Ewell personally, Councilmember Peters explained that he talked to Ewell about the issue in general. Ewell told him that Shipione was angry, that the SDCERS Board had outside fiduciary counsel, and that the Retirement System was not in trouble.

Mr. Dahlberg later inquired as to why Shipione's allegations were not referred back to the SDCERS Board -- given that that is how Council had approached the pension concerns raised in the BRC Report-- and instead went directly to the City Manager's Office, which Councilmember Peters had earlier stated a number of Council members thought was incompetent. Councilmember Peters explained that he was in contact with SDCERS Board members and staff. He believed that what Council would have learned from SDCERS was that Shipione was crazy and that the system was sound. Councilmember Peters believed, at that time, that the City Manager's Office served as the best source for objective information about Shipione's allegations.

Mr. Romano showed Councilmember Peters a December 31, 2002 letter from Shipione to Ewell copied to the Mayor and City Council among other recipients (Exhibit 11). Mr. Romano directed Councilmember Peters's attention to the language on page 1, which states, "the actuary confirmed that as of June 30, 2002, the fund had 'crashed' to a low of approximately 68% with an *unfunded* accrued *liability* of *$720 million*" (emphasis in original). Councilmember Peters noted this type of information as an example of something that Grissom had reassured him was not a problem. Explaining that one of Shipione's primary assertions in her letter was that Rick Roeder (SDCERS Board actuary) did not actually support MP2, Mr. Romano asked Councilmember Peters whether he recalled having any discussions with Roeder about that. Councilmember Peters believed that Roeder did not give the most "apparent" advice when it was most needed and did not object to the numbers (if they were incorrect) at the right time. Councilmember Peters explained that the perception was that Roeder supported MP2 and that fact provided Council members with the understanding that the proposal did not present a serious problem.

Mr. Romano showed Councilmember Peters an August 12, 2004 letter from Roeder to Councilmember Peters responding to a letter Councilmember Peters had written that was published in the San Diego Union-Tribune (Exhibit 12). Roeder's letter took issue with Councilmember Peters's suggestion in his published letter that Roeder had supported MP2. Mr. Romano pointed out that, as stated on page 7 of Shipione's December 31, 2002 letter (Exhibit 11), the SDCERS Board fiduciary counsel (Robert Blum) had stated that "it would be best to hold the City to the existing Manager's Proposal." Mr. Romano asked Councilmember Peters whether there was really a consensus at the time of MP2 that all the outside experts supported it. Councilmember Peters explained that there was mixed advice from counsel about the funding level and he relied on them (presumably, both Roeder and Blum) for advice about where the "serious" actuarial break would occur.

Presidential Leave

Referring to Councilmember Peters's earlier remark that he had spoken personally with Girard about potential conflicts of interest on the SDCERS Board, Mr. Romano asked

Councilmember Peters whether this was a reference to Saathoff's receipt of benefits. Councilmember Peters responded that it likely was, as Saathoff was the person most involved with negotiating his own benefits. Asked about his understanding of Saathoff's Presidential Leave benefit, Councilmember Peters stated that, "the way Presidential Leave was cast was a way to even it out," referring to the fact that two of the other union heads had already received this benefit. Councilmember Peters explained that the benefit also seemed valid because Saathoff's union had approved it, which demonstrated that Saathoff had not just unilaterally used his position to obtain the benefit but first cleared the plan with his constituents. Mr. Romano asked Councilmember Peters if he recalled the aspect of Saathoff's overall receipt of benefits that allowed him to use payments from his accrued leave time to purchase service time retroactively. Councilmember Peters could not recall this element, noting that he could only recall discussion of the Presidential Leave benefit and how the salary element of it would be calculated.

Legislative Officers' Retirement Plan

Mr. Romano asked about Council's vote in January 2002 to make retroactive beyond September 2000 certain modifications to the Legislative Officers' Retirement Plan ("LORP"). In particular, the September 2000 modifications lowered the vesting age for elected officials from 60 years of age to 55. Mr. Romano asked Councilmember Peters whether Council considered the financial impact this retroactive change would have on the budget. Councilmember Peters could not recall discussion of this measure. Mr. Romano noted that the voters had rejected Proposition C earlier in January 2002, which would have amended the City Charter to allow for the pensions of general members of the Retirement System to vest at the age of 55. Mr. Romano inquired whether there was any sense among Council members that the age 55 provision in LORP was potentially in contravention to the Charter. Councilmember Peters could not recall such a perception. Mr. Romano asked whether anyone in the City Attorney's Office ever came forward and explained that the legality of this provision was an open issue. Councilmember Peters could not recall anyone discussing this matter and he did not believe he ever received specific advice as to the provision.

Ballpark Offering and Disclosure Issues

Mr. Romano showed Councilmember Peters a November 6, 2001 memo from Girard to the Mayor and City Council with an attached letter from Bryan Cave discussing the due diligence duties of Council members in connection with the review of the Ballpark bond offering statement (Exhibit 13). Councilmember Peters recalled the presentation of this letter at the referenced closed session meeting, noting that Girard was accompanied by an attorney from Bryan Cave. This meeting came at a time when the Ballpark project -- but not necessarily the Ballpark bond offering, Councilmember Peters noted -- was "the biggest thing going." Councilmember Peters explained that there were many City staff in attendance at this meeting because of the concern surrounding the project, in particular because of the litigations surrounding the ballpark and the Valerie Stallings bribery scandal from earlier that year.

Councilmember Peters was rather certain that Girard and the Bryan Cave attorney did not walk Council members through the Bryan Cave letter. Rather, the objective of the meeting was to set up a defense to another potential lawsuit brought by Bruce Henderson -- in

this case, of the securities fraud variety -- as Council was informed that the City would have to win every lawsuit to be able to build the Ballpark. Councilmember Peters recalled that the Bryan Cave attorney advised the Council members to read through the materials provided, ask questions if they did not understand certain issues and to put on the record that they had read the documents. Councilmember Peters stated that, "this was not a lesson in securities law; it was a lesson in how to win a lawsuit" they anticipated that Henderson might bring.

Mr. Romano inquired whether Councilmember Peters believed it could be gleaned from the letter that there would be a problem if a Council member did not actually read a disclosure document. Councilmember Peters believed that this likely did not occur to the Council members because the meeting was just portrayed to Council members as a way to create a record that Council had examined the disclosure issue. Mr. Romano read language from page 3 of the letter which explains that elected officials cannot just "rubber-stamp" disclosure documents without first examining them. Mr. Romano asked whether any Council members inquired as to the nature of the due diligence duties described in the letter. Councilmember Peters could not recall any such questions, noting that the lesson from the meeting was that they should read the documents and be able to show that they did. It was unclear what they should be looking for in reading through the documents, though he speculated "to see if they were accurate, I guess." Asked whether they were given any practical advice as to the purpose of their review, Councilmember Peters could not recall but doubted that they received any specific guidance. Councilmember Peters noted that closed session level of discussion was "pretty rudimentary" because it "takes a while for people to understand what they are supposed to do." He believed that there was probably not a very extensive discussion at this particular meeting.

Mr. Haegele asked Councilmember Peters to clarify that, based on his and other Council members' backgrounds, they were expected to read disclosure documents for accuracy. Councilmember Peters stated that was his general understanding, noting that his primary background was in environmental law. Mr. Romano later showed Councilmember Peters the May 29, 2003 Balboa Park Refunding bond offering (Exhibit 14). Providing this document as an example of a bond offering statement, Mr. Romano asked Councilmember Peters about what part he would have read. Councilmember Peters noted that he believed they were asked to read the Preliminary Offering Statement.

After Councilmember Peters re-emphasized that the point of this meeting was simply to win a potential lawsuit, Ms. Naughton interjected that this meeting came up around the time of the Stallings debacle, after which Council had to revote on all the Ballpark-related issues. There was a concerted effort to avoid these difficulties going forward. Mr. Romano asked whether Councilmember Peters viewed the advice in the letter as knowledge he should take with him for future bond offerings. Councilmember Peters explained that the letter and advice at the meeting was presented to Council as applicable to the Ballpark offering but not necessarily as general advice. Mr. Romano sought clarification as to whether what was discussed at this closed session meeting only applied to the Ballpark matter in particular. Councilmember Peters affirmed that this was the case.

Mr. Romano asked Councilmember Peters about when he received this letter. He was not certain, but he noted that Council members would not have received it until at least the Friday before the closed session meeting and they would not have been able to keep the letter

after the meeting because of the sanctity of the closed session process. Councilmember Peters noted that his practice is to leave the documents at the meeting even if they are not specifically collected at the end. Mr. Romano asked whether it would have been unusual for someone to take the letter with them after the meeting. Councilmember Peters believed that it would have.

CAFRs and Disclosure Issues

Mr. Romano asked Councilmember Peters about the mindset of Council when CAFRs were voted on. Councilmember Peters could not recall since it has been a while since Council has approved a CAFR, noting that the Voluntary Disclosures in 2004 were made without any input from Council. Mr. Romano asked generally whether there was an awareness about issues that Council had heard earlier in the year (during the budgeting process and thereafter) that carried forward to the review of financial statements at the end of the year. Councilmember Peters could not recall, but explained that Council members were not educated as to how to approach and review these kinds of documents and this lack of training is a prime area for improvement.

Wastewater

Mr. Romano showed Councilmember Peters a January 29, 2002 Closed Session Report for a meeting held that day (Exhibit 15). Noting that the docket sheet stated that Kelly Salt (Deputy City Attorney) had spoken at this meeting, Mr. Romano asked Councilmember Peters whether he recalled her presentation. Councilmember Peters noted that, based on the vote chart at the bottom of the document, he was absent from this meeting. Asked whether he knew Dennis Kahlie (City Utilities Finance Administrator), Councilmember Peters stated that he did. Mr. Romano asked Councilmember Peters whether he was aware of the rate structure adjustment issue that was discussed at this meeting. Councilmember Peters noted that he was aware of the issue and the Cost of Service ("COS") studies that were conducted in connection with it.

Mr. Romano showed Councilmember Peters a January 29, 2002 email from Kahlie to Girard regarding what was discussed at the January 29, 2002 Closed Session meeting (Exhibit 16). Mr. Romano asked Councilmember Peters whether he was aware at the time about what was discussed in this email, in particular the sewer rate allocation compliance requirements connected to the receipt of State loans and Federal grants. Councilmember Peters could not recall being aware of this issue at the time, noting that his committee (Natural Resources and Culture Committee) would not have seen this fee issue because it would have gone straight to Council. Mr. Romano asked Councilmember Peters about when he first understood that the City had to adjust its sewer rate structure. Councilmember Peters recalled that he did not fully understand the issue until it was mandated that the City change, noting that he recalled first learning that the City had to conduct a COS study to examine the appropriateness of its rate structure. He could not recall the specifics of the COS study, only that it occurred while he was in office.

Mr. Romano showed Councilmember Peters a November 14, 2002 memorandum from Vattimo and Salt to the Mayor and City Council (Exhibit 17). Councilmember Peters believed that Council learned about the need for a COS study around this time. Mr. Romano later clarified whether this was the first time Councilmember Peters was aware of the necessity of conducting a COS study, to which Councilmember Peters mostly agreed with this statement.

Mr. Romano pointed to language in the memorandum that unequivocally stated that the City was out of compliance with rate allocation requirements. Councilmember Peters stated that he could only recall learning about the need for a COS study to examine compliance issues and was not certain whether he understood the City was out of compliance at that time.

Mr. Romano showed Councilmember Peters a November 22, 2002 memorandum from Ewell to the Mayor and City Council with an attached draft of a May 2002 Black & Veatch COS study (Exhibit 18). Mr. Romano explained that the Audit Committee believed that Councilmember Donna Frye had requested that this COS study be released as early as May 2002. Asked whether he had knowledge of such a request in May 2002, Councilmember Peters recalled that he knew Councilmember Frye wanted to see a COS study, but he did not know why the study was not completed -- or she was not shown it -- earlier.

Mr. Romano asked Councilmember Peters whether he could recall why the closed session meeting at which the November 14, 2002 Vattimo and Salt memorandum was to be discussed was cancelled. Councilmember Peters could not. Asked whether he could recall any discussion (involving Councilmember Frye) about whether this general issue should be discussed in open or closed session, Councilmember Peters could only recall that Councilmember Frye had wanted to see a COS study.

Mr. Romano asked Councilmember Peters about his understanding of the issue after he read the November 14, 2002 memorandum stating that the City was out of compliance. Councilmember Peters explained that one cannot look at this issue in hindsight and assume that the State would have ever asked for its loans back. He stated, "we sort of own the bank, and there is no politician in Sacramento that is not going to give us a chance to fix it." The notion that the State would ever take $300 million back from the City without prior discussion simply did not exist in his mind. He could not recall whether this sentiment was discussed at the time. Mr. Romano noted that citizens could have sued based on the inequitable rates. Councilmember Peters dismissed this issue as one that had not been raised. Councilmember Peters analogized the wastewater situation to a previous time when the City was informed that its drinking water might not have been safe. Councilmember Peters recalled that Council put this issue on the calendar with the intent of looking into it in the future, but did not feel any immediate threat that it would lose its clean water-related funding. Similarly, Councilmember Peters explained that when Council was told about the need to comply with the sewer rate requirements, they met this demand by requesting a COS study. He explained that once Council received the study, it was a "blessing" because they could then use that as a vehicle to make the otherwise difficult decision to modify the system.

Mr. Romano inquired as to what was difficult about the decision. Councilmember Peters explained that, when he was elected, it was clear that Council needed to raise rates (presumably, both water and sewer). These types of actions require compromises that are often painful to reach; thus, he believed that it was a "gift" whenever the State comes in and states a certain action is mandatory. Mr. Romano asked why it took so long to implement the gift from the State Water Resources Control Board, which was received directly toward the end of 2003 and earlier through reports to Council. Councilmember Peters explained that they did not believe that compliance was in fact mandatory as this issue developed. He noted that Council would often speak with Scott Tulloch (MWWD Director) -- whom Council believed was

competent -- and he would explain the true nature of the State's demand. Councilmember Peters stated that, overall, he really did not care about the result of the issue (*i.e.*, whether the rate structure was changed or left the same), but rather just wanted to see it come to an end.

Mr. Romano asked Councilmember Peters whether he recalled having any meetings with Kelco. Councilmember Peters noted that he met with Kelco as well as many other lobby groups on both sides of the issue. Asked whether he believed that Kelco's involvement slowed down the compromise process, Councilmember Peters recalled that the restaurants also played a big role in dragging out the road toward a compromise and that, ultimately, most opinions were heard before the State "laid down the gavel" on the issue. Mr. Dahlberg asked Councilmember Peters whether he could recall any Council members in the debate leaning one way or the other. Councilmember Peters responded that he believed such a leaning only existed as to rate increases, not rate apportionment.

Mr. Romano asked Councilmember Peters why he believed nothing was done about the rate allocation issue before he was elected in 2000. Councilmember Peters speculated that this was probably because of political ambitions, noting that Mayor Susan Golding had wanted to run for Senate and Councilmember Juan Vargas to run for some other office. Councilmember Peters did not believe this political pressure could have just come from Kelco, as the restaurants had a particularly strong lobby in San Diego. Mr. Romano asked about Doug Sain's influence on Council once Councilmember Peters was elected. Councilmember Peters explained that Sain just explained his side's position but did not do anything out of the ordinary in terms of his lobbying approach.

In summary, Mr. Romano asked Councilmember Peters whether, looking back at the protracted discussion about the sewer rate issue, he believed that the lack of a threat of rescission of the City's loans and grants created the slow response. Councilmember Peters stated that the issue was not that simple, noting also that COS studies were expensive and that added to any potential delay in response. Councilmember Peters was not aware that there had been previous COS studies conducted before the one Council received in November 2002.

Remediation

Mr. Romano explained that, based on his conversations with other Council members, he understood that Council may convene and discuss potential changes to recommend. Mr. Romano asked Councilmember Peters if he had any ideas regarding remediation he wanted to share with the Audit Committee. Councilmember Peters explained the general challenge with a governmental system is that the people elected to office are regular people and are not always the best and the brightest.

Councilmember Peters believed that the move to the strong Mayor form of government was a good first step. He noted that he already has seen an increased flow of information throughout the government. Before, information tended to only flow from the City Manager's Office to City Council and not the other way around. Councilmember Peters believes that there needs to be a shared appointment power between the Mayor and the City Manager and some elected positions should be appointed to assure that the right people are chosen. He believes that Council should give advice and consent as to the appointment of the City Auditor & Comptroller. With regard to Mayor Jerry Sanders's effort to bring the City Auditor &

Comptroller under the umbrella of the Mayor's Office, Councilmember Peters is a bit wary as he believes this office should maintain some degree of independence.

With regard to potential changes to the retirement system, Councilmember Peters noted that certain changes have already been implemented, namely the mandate that a 15 year amortization period be used and the appointment of an independent actuary to advise the Mayor and City Council. In terms of closing the funding gap, Councilmember Peters supports the use of pension obligation bonds.

Mr. Romano asked Councilmember Peters about his perception of a number of the changes that were adopted from a draft ordinance contained in the first Vinson & Elkins ("V&E") investigative report. In particular, Mr. Romano inquired as to whether the creation of a special disclosure counsel position within the City Attorney's Office was a good idea. Councilmember Peters explained that he is somewhat concerned about this change, as he believes that it is not prudent to rely on a City employee as disclosure counsel. It is better to rely on outside experts for this type of advice. Councilmember Peters believes that there is no one in the City Attorney's Office that understands federal securities law. Councilmember Peters noted that V&E's recommendations were adopted because they seemed like good ideas at the time though he is still reluctant to build the advice of outside counsel into the City apparatus. He explained that it has been difficult over the last several years to know who to trust, so maintaining contact with outside arbiters is essential.

With regard to the review of CAFRs and bond disclosure statements, Councilmember Peters later emphasized that training Council members should also involve stressing to them the basic concepts underlying borrowing money from the public so that they can understand the full implications of their responsibility. Training should be done by outside counsel and there should be a certification process to ensure those that are advising the Council members are competent. Councilmember Peters expressed the sentiment that, even with the intelligence of the present Council members, it still takes a long time for them to understand complex issues. Ms. Naughton interjected that the SEC has told the Council members that if they ask at the time of approving a bond offering whether all the information is accurate and disclosed, that will satisfy their securities law duties. However, Mr. Romano and Councilmember Peters agreed that that is probably not sufficient to discharge their duties. Mr. Romano suggested that a brief memo accompany a particular bond offering statement that discusses -- in plain language and in a format that provides both sides of a particular issue -- all the potential issues surrounding the offering. Councilmember Peters agreed with this idea but noted that at a certain point, the information would likely all be included within the disclosure.

Mr. Romano asked Councilmember Peters about what structural changes are needed to change the lack of trust running through the government. Councilmember Peters believes that it is basic human nature that matters are not always dealt with transparently in government. He believes that the only way to get around this tendency with regard to fiscal matters is to implement rigorous accounting standards such that no one can bend the rules at the margins. Not only would this help address the transparency issue, but also it would aid elected officials who may not have the background knowledge to deal with technical financial issues.

On a final note, Councilmember Peters explained that, unlike corporations which have an incentive to make accurate disclosures to maintain a good image in the market, there is less incentive for municipal issuers beyond maintaining a strong bond rating. Councilmember Peters believes that the City needs to find more ways to build this incentive into the structure of government as a guard against some of the sloppiness and suppression of information that has previously impacted the City.

WF&G

3262887.2