INTERIM REPORT NO. 2

REGARDING POSSIBLE ABUSE, ILLEGAL ACTS OR FRAUD BY CITY OF SAN DIEGO OFFICIALS

REPORT OF THE SAN DIEGO CITY ATTORNEY MICHAEL J. AGUIRRE

OFFICE OF
THE CITY ATTORNEY
CITY OF SAN DIEGO

1200 THIRD AVENUE, SUITE 1620
SAN DIEGO, CALIFORNIA 92101-4178
TELEPHONE: (619) 236-6220

9 FEBRUARY 2005

EXHIBITS 1-77

Section 38: City Clerk

The City Clerk shall be elected by the Council for an indefinite term and shall serve until his successor has been elected and qualified. He shall maintain all official records of the City, the custody of which is not provided for in this Charter or by ordinances of the City, including the journal of all proceedings of the Council and all its ordinances and resolutions.
(Amendment voted 09-17-1963; effective 02-11-1964.)

Section 38.1: Microfilming of Records.
(Addition voted 04-19-1949; effective 05-20-1949.)
(Repeal voted 11-04-1958; effective 02-19-1959.)

Section 39: City Auditor and Comptroller

The City Auditor and Comptroller shall be elected by the Council for an indefinite term and shall serve until his successor is elected and qualified. The City Auditor and Comptroller shall be the chief fiscal officer of the City. He shall exercise supervision over all accounts, and accounts shall be kept showing the financial transactions of all Departments of the City upon forms prescribed by him and approved by the City Manager and the Council. He shall submit to the City Manager and to the Council at least monthly a summary statement of revenues and expenses for the preceding accounting period, detailed as to appropriations and funds in such manner as to show the exact financial condition of the City and of each Department, Division and office thereof. No contract, agreement, or other obligation for the expenditure of public funds shall be entered into by any officer of the City and no such contract shall be valid unless the Auditor and Comptroller shall certify in writing that there has been made an appropriation to cover the expenditure and that there remains a sufficient balance to meet the demand thereof. He shall perform the duties imposed upon City Auditors and Comptrollers by the laws of the State of California, and such other duties as may be imposed upon him by ordinances of the Council, but nothing shall prevent the Council from transferring to other officers matters in charge of the City Auditor and Comptroller which do not relate directly to the finances of the City. He shall prepare and submit to the City Manager such information as shall be required by the City Manager for the preparation of an annual budget. He shall appoint his subordinates subject to the Civil Service provisions of this Charter.
(Amendment voted 06-04-1974; effective 08-13-1974.)

EXHIBIT # 1

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

---

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)

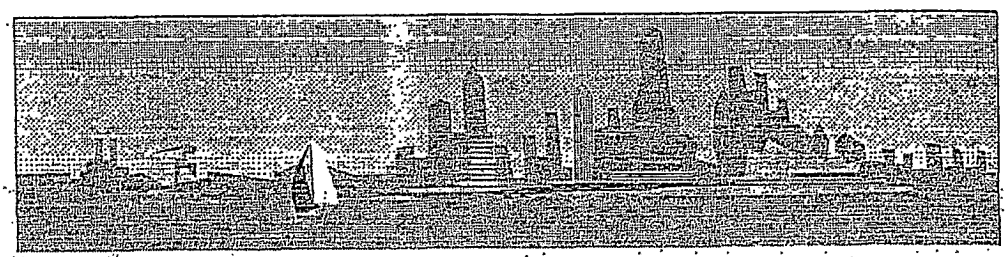
* The actuary report for 6/30/96 reflected a funding ratio of 92.3% for combined City and Port assets. The 92.3% is the ratio used in the 1996/97 Manager's Proposal. That funding ratio 6/30/96 for only the City's portion of the system assets was 91.4%. A more accurate floor which would trigger the full 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

SAN DIEGO CITY
EMPLOYEES' RETIREMENT SYSTEM

ANNUAL ACTUARIAL VALUATION

JUNE 30, 2003



SUBMITTED TO
THE RETIREMENT BOARD
SAN DIEGO CITY EMPLOYEE'S RETIREMENT SYSTEM
SAN DIEGO, CALIFORNIA

[GABRIEL, ROEDER, SMITH & COMPANY]

EXHIBIT # 3

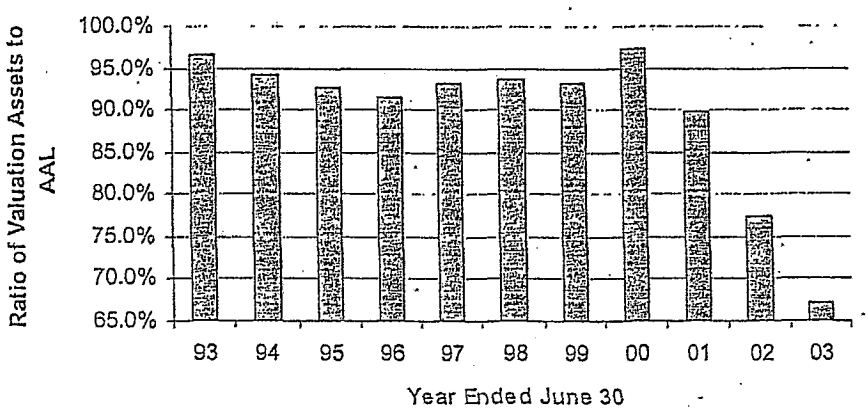
San Diego City Employees' Retirement System
Funding Process Indicators - Historic Comparison

($ in Thousands)

Valuation Date	Valuation Assets	Continuation Indicators: AAL	Funded Ratio	UAAL	Member Payroll	Ratio to Payroll
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]	$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%
6/30/02	$2,448,208	$3,168,921	77.3%	$720,713	$535,157	134.7%
6/30/03	$2,375,431	$3,532,626	67.2%	$1,157,194	$533,595	216.9%

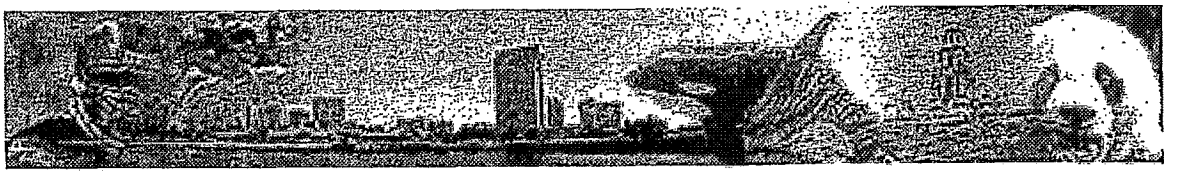
AAL - Actuarial Accrued Liability
UAAL - Unfunded Actuarial Accrued Liability

Historic Comparison of Funding Value



[1] Reflects revised actuarial and economic assumptions
[2] Reflects Manager's Proposal
[3] Reflects Corbett non-contingent benefit increases

SAN DIEGO CITY
EMPLOYEES' RETIREMENT SYSTEM
ANNUAL ACTUARIAL VALUATION
June 30, 2004



Submitted to

THE RETIREMENT BOARD

San Diego City Employees' Retirement System

San Diego, California

EXHIBIT # 4

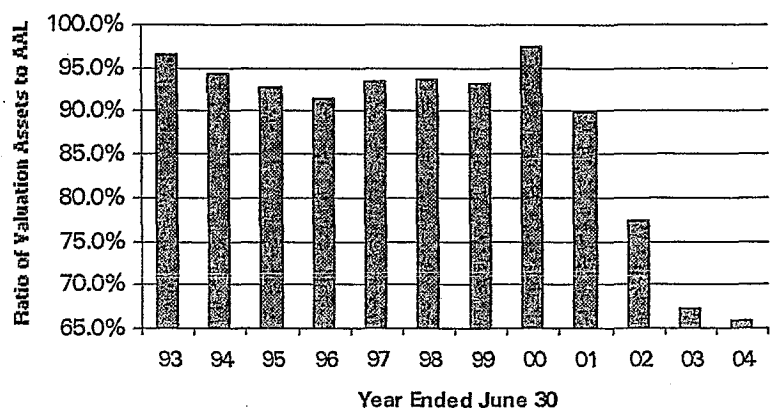
San Diego City Employees' Retirement System
Funding Process Indicators - Historic Comparison

($ in Thousands)

Valuation Date	Valuation Assets	Continuation Indicators: AAL	Funded Ratio	UAAL	Member Payroll	Ratio to Payroll
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]	$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%
6/30/02	$2,448,208	$3,168,921	77.3%	$720,713	$535,157	134.7%
6/30/03	$2,375,431	$3,484,832	68.2%	$1,109,401	$533,595	207.9%
6/30/03[4]	$2,375,431	$3,532,626	67.2%	$1,157,194	$533,595	216.9%
6/30/04	$2,628,680	$3,962,237	66.3%	$1,333,557	$540,181	246.9%
6/30/04[5]	$2,628,680	$3,997,328	65.8%	$1,368,648	$540,181	253.4%

AAL - Actuarial Accrued Liability
UAAL - Unfunded Actuarial Accrued Liability

Historic Comparison of Funded Ratio



[1] Reflects revised actuarial and economic assumptions
[2] Reflects Manager's Proposal
[3] Reflects Corbett non-contingent benefit increases
[4] Includes change in benefits for General Members
[5] Reflects revised actuarial assumptions

City of San Diego
Labor Relations Office
MEMORANDUM

Date: July 23, 1996

To: Larry Grissom, Retirement Administrator

From: Cathy Lexin, Labor Relations Manager

Subject: *CITY MANAGER'S RETIREMENT PROPOSAL*

Per your request, attached hereto is a consolidation of the *final* Retirement Proposal as presented to the Retirement Board at its meeting of June 21, 1996. This Proposal was subsequently presented to and approved by the City Council at its meeting of July 2, 1996.

It is my understanding that the action taken by the Board was to defer any action required of them on **Issue No. 1 - Retiree Health Insurance** based on advice of Fiduciary Counsel Dwight Hamilton until such time as a specific health plan was presented for his review and advice and until a Charter amendment occurred enabling the Retirement Board to administer retiree health insurance.

Issue No. 2 - CERS Benefit Changes identified benefit improvements being recommended by the Manager to the City Council; no action was required of the Retirement Board.

It is further my understanding that the Retirement Board approved in concept the recommended actions contained under **Issue No. 3 - Employer Contribution Rates**, and **Issue No. 4 - Surplus Undistributed Earnings and Reserves**, including the set aside of approximately $135 million from excess undistributed earnings for the purpose of carrying out the proposal, contingent upon the retiree health insurance portion being successfully resolved by January 1, 1997.

G. The City agrees to implementation of a ***Deferred Retirement Option Plan*** (DROP) effective April 1, 1997, on the condition that such a plan is approved by the City Attorney's Office as legal under applicable Federal, State and Local laws and regulations, and that such a plan would not increase cost greater than the savings to the City nor CERS. Employees may participate in this program for up to five (5) years. At the end of three (3) years, the City will evaluate the cost impact of this program. If the cost impact to the City or CERS is greater than the savings, the City agrees to meet and confer to impasse prior to imposing any changes in the DROP Plan. If the City proposes to change the DROP Plan, the 90% cap on CERS would also be re-negotiated. Employees who elect to participate in DROP will cease participation in CERS, and will participate in an SPSP-type plan with a mandatory 3.05% employee contribution matched by 3.05% employer contribution.

Issue No. 3 - EMPLOYER CONTRIBUTION RATES

A. Employer rates will be calculated using the Projected Unit Credit (PUC) method. For FY96 and FY97, the City will pay the budgeted rates (bifurcated rate) of 7.08% (blended rate) and 7.33% respectively, and increase the rate paid by 0.50% each year until the rate paid reaches the EAN calculated rate. At such time as the PUC and Entry Age Normal (EAN) rates are equal, the System will convert to EAN.

Employer Contribution Rate Stabilization Plan

Period	PUC Rate	City Paid Rate	Difference %	Difference $
FY96	8.60%	7.08%	1.52%	$5.33m
FY97	10.87%	7.33%	3.79%	$13.88m
FY98	12.18%	7.83%	4.35%	$16.67m
FY99	12.18%	8.33%	3.85%	$15.40m
FY2000	12.18%	8.83%	3.35%	$14.00m
FY2001	12.18%	9.33%	2.85%	$12.45m
FY2002	12.18%	9.83%	2.35%	$10.72m
FY2003	12.18%	10.33%	1.85%	$8.82m
FY2004	12.18%	10.83%	1.35%	$6.73m
FY2005	12.18%	11.33%	.85%	$4.43m
FY2006	12.18%	11.83%	.35%	$1.91m
FY2007	12.18%	12.18%	-0-	-0-
FY2008	13.00	13.00%	-0-	-0-
TOTAL				$110.35*

*$110.35 million paid from excess earnings includes $71.31 million in contributions as a result of benefits improvements recommended herein.

B. The City will pay the agreed-to rates shown above for FY 96 through FY 2007. 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 which will include the impact of the benefit improvements included in this Proposal, 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.

C. If the System's actuary makes changes in actuarial assumptions or methodology which are approved by the Board prior to July 1, 2007, any changes in the employer contribution rate will adjust the PUC rate to be achieved through extended incremental increases shown in paragraph A above. If the phase-in would require an extension past July 1, 2009 in order to achieve the full actuarial PUC rate, the City-paid rate will be adjusted by the amount necessary to achieve full phase-in by that date.

Issue No. 4 - SURPLUS UNDISTRIBUTED EARNINGS AND RESERVES

The System's actuary performs an annual actuarial valuation which shows the present value of accrued liabilities and the value of assets allocated to funding. To the extent that liabilities exceed assets, the System will show an unfunded liability. The System's liabilities will be impacted in the following ways, including those related to the City Manager's proposal for restructuring the System.

NORMAL LIABILITIES - This liability relates to the impact of actuarial gains or losses recognized when actuarial assumptions are compared to the System's actual experience. When experience is better than assumptions, the System shows actuarial gains and liabilities decrease. When experience is worse than assumptions, the System shows actuarial losses and liabilities increase. This will take place regardless of whether or not the restructuring proposal is approved.

NORMAL COST OF INCREASED BENEFITS - When benefits are increased, liability is created representing the prospective value of those benefits. Employee and employer contribution rates are increased for the purpose of paying that cost as it is accrued.

PAST SERVICE LIABILITY OF INCREASED BENEFITS - The proposed restructuring provides for an increase in the formula for calculating benefits. This means that, in the case of a general member, each year of accrued service that had a value of 1.45% of final average salary at age 55, increases in value to 2.00% of final average salary at age 55 upon the effective date of the increase. This increases the cost to the System to pay the benefit, which increases liabilities since no contributions have been received in the past to fund the benefit at this level. This is what is known as past service liability.

The actuary has estimated the amount of past service liability created by the restructuring proposal to be $76.7 million expressed in 1996 dollars.

CONTRIBUTION SHORTFALL LIABILITY - The restructuring proposal provides that the employer contribution rate will be "ramped up" to the actuarially recommended rate in increments over the next 10 years. This means that the System will be receiving less in contribution dollars over that period, which creates an additional liability.

The actuary has estimated the amount of contribution shortfall liability created by the restructuring proposal to be $30.0 million expressed in 1996 dollars.

A. The system has "surplus" undistributed earnings and a balance in the Earnings Stabilization Reserve as follows:

FY ended 6-30-95	$ 38,813,314
FY ended 6-30-96	85,472,254
Earnings Stabilization Reserve	10, 769,620
Total	$135, 055,188

The actuary has estimated increased liabilities associated with the restructuring proposal in the amount of $106,700,000 (see the discussion segment above). Credit the Employer Contribution Reserve in the amount of $106,700,000 for the purpose of discharging the restructuring liability. Credit the Employer Contribution Reserve with $28,356,188 (the remaining balance) for the purpose of reducing the System's normal unfunded liability.

TOTALITY OF THE PROPOSAL

If the necessary contingencies identified to approve this Proposal in its entirety are not affirmatively met by January 1, 1997, then:

A. Retiree Health Insurance will remain a City provided benefit, rather than CERS;

B. The CERS benefit improvements listed in Issue No. 2 would not occur;

C. The employer contribution rates to be paid would be those established by the System's Actuary.

In order to facilitate the accomplishment of this Proposal, it is recommended that the CERS Board direct that the $106,700,000 identified in Issue No. 4 as the amount necessary to discharge the restructuring liability be set aside in a reserve until January 1, 1997.

SAN DIEGO CITY
EMPLOYEES' RETIREMENT SYSTEM
ANNUAL ACTUARIAL VALUATION
JUNE 30, 1996

Submitted to

THE RETIREMENT BOARD

San Diego City Employees' Retirement System

San Diego, California

EXHIBIT # 6

San Diego City Employees' Retirement System

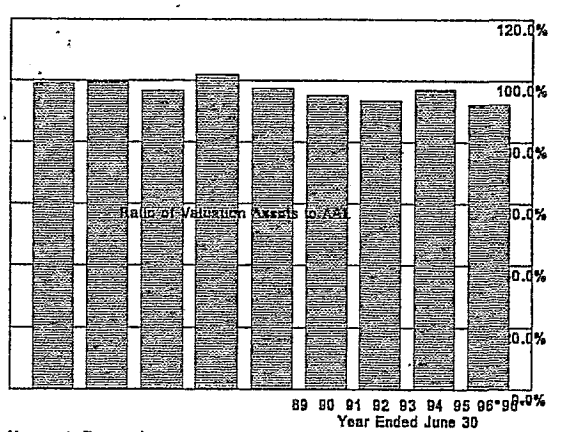
Funding Progress Indicators - Historic Comparison

($ in Thousands)

Continuation Indicators

Valuation Date	Valuation Assets	AAL	Funded Ratio	UAAL	Member Payroll	Ratio to Payroll
6/30/89[1]	829,918	838,289	99.0%	8,371	241,384	3.5
6/30/90	899,328	903,320	99.6	3,992	271,421	1.5
6/30/91[1,2]	973,075	1,006,300	96.7	33,225	303,471	10.9
6/30/92[1]	1,077,135	1,057,239	101.9	(19,896)	331,663	(6.0)
6/30/93[1,3,4]	1,189,184	1,220,830	97.4	31,646	340,732	9.3
6/30/94[5]	1,273,827	1,338,280	95.2	64,453	360,173	17.9
6/30/95	1,380,436	1,476,711	93.5	96,274	372,967	25.8
6/30/96	1,553,283	1,600,106	97.1	46,824	388,646	12.0
6/30/96[6]	1,553,283	1,682,605	92.3	129,322	388,646	33.0

AAL -- Actuarial Accrued Liability
UAAL -- Unfunded Actuarial Accrued Liability



* Prior to Manager's Proposal
** After Manager's Proposal

[1] Reflects benefit changes for certain member groups
[2] Reflects changes in funding method
[3] Reflects changes in member contribution rate
[4] Reflects early retirement program activity, and change in member refund method
[5] Reflects revised actuarial and economic assumptions
[6] After Manager's Proposal

(Amendment voted 11-06-1990; effective 02-19-1991.)
(Amendment voted 11-08-1994; effective 01-30-1995.)
(Amendment voted 11-05-1996; effective 02-10-1997.)

Section 142: Employment of Actuary

The Board of Administration hereinafter provided, shall secure from a competent actuary a report of the cost of establishing a general retirement system for all employees of The City of San Diego. Said actuary shall be one who has had actual experience in the establishing of retirement systems for public employees, and his position shall be considered one requiring expert or technical training within the meaning of subdivision (k) of Section 118 of Article VIII of this Charter.

Section 143: Contributions

The retirement system herein provided for shall be conducted on the contributory plan, the City contributing jointly with the employees affected thereunder. Employees shall contribute according to the actuarial tables adopted by the Board of Administration for normal retirement allowances, except that employees shall, with the approval of the Board, have the option to contribute more than required for normal allowances, and thereby be entitled to receive the proportionate amount of increased allowances paid for by such additional contributions. 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.
(Amendment voted 03-13-1945; effective 04-09-1945.)
(Amendment voted 06-08-1954; effective 01-10-1955.)

Section 143.1: Approval of Amendments by Members

No ordinance amending the retirement system which affects the benefits of any employee under such retirement system shall be adopted without the approval of a majority vote of the members of said system. No ordinance amending the retirement system which affects the vested defined benefits of any retiree of such retirement system shall be adopted without the approval of a majority vote of the affected retirees of said retirement system.
(Addition voted 06-08-1954; effective 01-10-1955.)
(Amendment voted 11-06-1990; effective 02-19-1991.)

Section 144: Board of Administration

EXHIBIT # 7

DIVISION 8
City's Contribution

("Method of Financing" Incorp. 1–22–52 by O–5046 N.S., contained in O–10792 O.S. adopted 11–29–26; repealed 10–25–62 by O–8744 N.S.)
("City's Contribution" added 10–25–62 by O–8744 N.S.)

§ 24.0801 City's Contribution

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. The required City contributions shall be determined separately by the Actuary for General Members and Safety Members.

All deficiencies which may accrue as a result of the adoption of any section in the Retirement Ordinances must be amortized over a period of thirty years or less. Any amount designated pursuant to Section 24.1203(b)(5) shall not constitute a deficiency within the meaning of this section.

(Amended 3–31–97 by O–18392 N.S.)

§ 24.0802 Social Security Integration — Payment to Federal Government

(Repealed 1–18–82 by O–15653 N.S.)

§ 24.0803 City Contribution — Special Class Safety Members

Commencing July 1, 1955, the City shall contribute to the retirement fund in respect to special class safety members each year such amount of money as shall be sufficient to provide for all of the retirement allowances, including service, disability and death which are authorized under the Charter to be paid to special class safety members.

(Title added 12–8–76by O–11964 N.S.)

§ 24.0804

(Repealed 4–30–63 by O–8818 N.S.)

§ 24.0805 Pension Accumulation Account

(Repealed 10–25–62 by O–8744 N.S.)

§ 24.0806 The Pension Reserve Account

(Repealed 10–25–62 by O–8744 N.S.)

§ 24.0807 Expense Fund

(Repealed 10–25–62 by O–8744 N.S.)

§ 24.0808 Estimate of Appropriations Required

(Repealed 10–25–62 by O–8744 N.S.)

§ 24.0809 Unclaimed Benefits

(Repealed 10–25–62 by O–8744 N.S.)

§ 24.0810 Retroactive Effect

(Repealed 10–25–62 by O–8744 N.S.)

EXHIBIT # 8

Mail

Close

Previous Next

From: Terri Webster
To: Grissom, Lawrence
CC: Lexin, Cathy
Date: 12/3/2001 10:06 AM
Subject: earnings EEEK !

Larry

Oct statements showed $15.4 m loss on sale of stocks and a total monthly loss of $7m bringing YTD earnings at Oct 31, 2001 to only $14.1 million compared to $107 m last year same time. A 87% decrease ! EEEK !

In Sept you said Doug and you were comfortable that FY 02 earnings would be enough to cover the "base " needs...about $120m. Are you still on track for that? Was the October loss of $7m a part of that plan ?

Sincerely,
Sleepless in San Diego

EXHIBIT # 9

Mail

Close

Previous Next

From: Cathy Lexin
To: Webster, Terri
CC:
Date: 1/3/2002 10:03 AM
Subject: Re: cers

thanks for the info

>>> Terri Webster 1/3/02 9:45:20 AM >>>
Ed
CERS fund earnings as of 11-30-01 was $17.4 million compared to $112.6 at 11-30-00 (85% decrease). {Oct was a 87% decrease so slight movement in the right direction occured.}
In order to fund the basic items listed in the Muni Code out of earnings using FY 01 numbers .... $118m is needed.
Out of the $118 the top 3 items were $78 m (credit employer and employee reserves; operating budget; and credit drop accounts).
Most of the remaining $40m has some flexibility....:Board can vote not to increase Health reserve or credit Board reserves with interest; or lower assumed interest rate; 13th check has a separate reserve; Corbett can be accured; NPO is a question.
Anyway.....these are SERIOUS consequences and needs attention....it can be discussed in Cathy's briefing with Larry on Tues....
Terri

and within those items there is some flexibility to reduce ....ie. Corbett can be accrued....13th check reserve exists....board could change the 8% interest assumption....interest to some reserves can be waived...

EXHIBIT # 10

Mail

Close

Previous Next

From: Terri Webster
To: Ryan, Ed
CC:
Date: 2/12/2002 2:43 PM
Subject: EGF and CERS

I'm available on the above subjects when you are.....

Per Larry the actuary report shows a $200M loss....that's a $486m swing from the last report. Funding ratio drops to 90% from 97% ...this assumes the $100m set aside for meet and confer is in assets. The trigger point is 82%. Weighted total contribution rate goes up 3% from 12.89 to about 15.89%.
Ugly Ugly

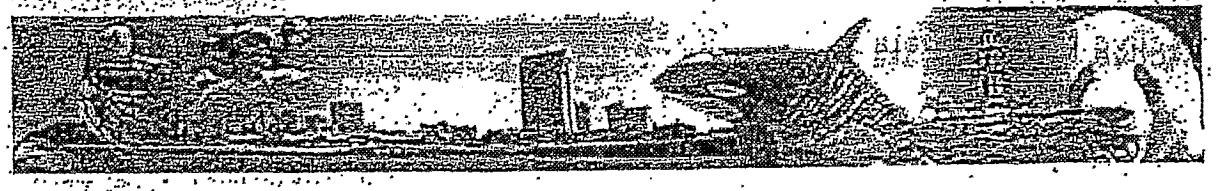
They project a $60m shortfall for FY 02 earnings

EXHIBIT # 11

1 [illegible] — no point to [illegible]
2. Require Retirement officer to come to Rules Committee in March if they don't make Retirement Bd. with Plan & 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

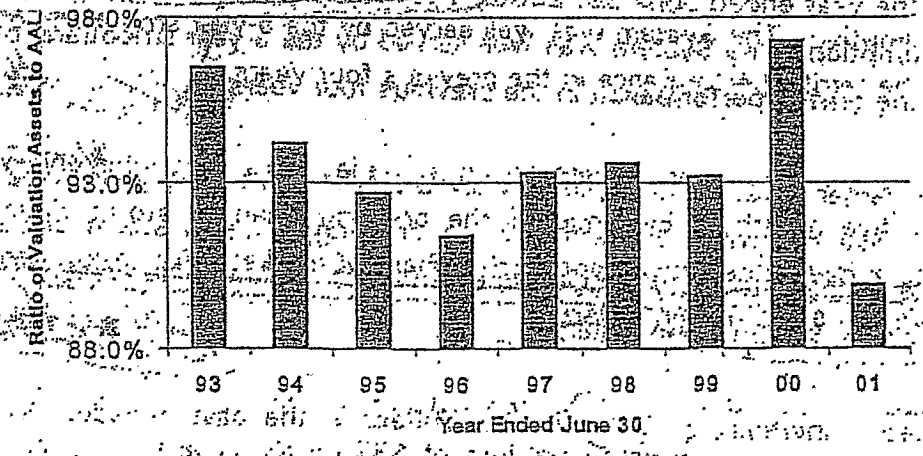
San Diego City Employees' Retirement System
Funding Process Indicators - Historic Comparison

($ in Thousands)

Valuation Date	Valuation Assets	Continuation Indicators: AAL	Funded Ratio	UAAL	Member Payroll	Ratio to Payroll
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]	$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



[1] Reflects revised actuarial and economic assumptions

[2] Reflects Manager's Proposal

[3] Reflects Corbett non-contingent benefit increases

Mail

Close

Previous Next

From: Terri Webster
To: Rgarnica@unitedcalbank.com
CC:
Date: 3/18/2002 5:14 PM
Subject: CERS

Hi Ray

I think your questions centered around why does the City care about the solution to the FY 02 earnings problem?

Answer: For many reason....the four biggest ones are:

1. Funding Ratio: Fiscal time bomb is attached to this. If it drops below 82.3% the City has to pay an additiona approx $26m a year.

Solutions that do not impact the funding ratio are the best. We need to know what the impact to the ratio is for the earnings solution....as well as I asked for the projected ratio based on FY 02 earnings.

The funding ratio is dropping rapidly in the present and last 2 year's investment market. If it dropped from 97.3% to 89.9% in one year and FY 02 earnings are 1/5 of the FY 01 earnings....then it is likely to drop real close to the 82.3% trigger. Therefore anything that negatively impacts the ratio needs to be known ASAP.

2. Rating Agency impacts:

The Funding Ratio is a fiscal indicator of the health of the CERS fund which is a major fund of the City. A large drop in funding ratio or dropping below certain benchmarks could result in a negative impact to the City's cred ating. The City has a high credit rating which is vital to keep borrowing costs down for future issuances on the horizon such as for fire stations, main library , and branch libraries, etc.

3. Plan for more declines and Preserve every basis point of the ratio: this is essential now since the impact of the bad market is far from over....the actuary lags a year...so we probably have at least 2 very more lean years ahead.
Don't use assets unless absolutely have to.

4. Meet and Confer: is going on now... .answers are needed from retirement now as compensation offers are being exchanged and the Mayor, Council and City Manager need to know what the current and projected CERS status is as they consider possible retirement enhancements.

These are quick thoughts. Call 236-5566 if you want to discuss

Terri

EXHIBIT # 13

TW Box 52 19/20

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

TW Box 52
19/30

— Cecilia
• f/s on time?
• what calc on-er-reserve 6-30-01?

From: Terri Webster
To: Lawrence Grissom
Date: 4/15/02 5:58PM
Subject: Re: Don't shoot the messenger — II

larry
....it doesn't make sense that the
Board (or last resort City Council) doesn't have the authority
to credit less than 8%.....I'll think more about all this and talk to you on Tuesday.....also awaiting actuary answers like how exactly calculate the $95.6 loss....also I think the 89.9% in around 89% since it appears the actuary counted all of the 105M reserve as since versus just the 100M.....

>>> Lawrence Grissom 04/15/02 03:24PM >>>
Terri
Please treat this as confidential for the moment.....haven't shared with any of the other Board members — yet.

* Earnings are currently projected at $43 Million. We have $17 million in unrealized losses in the Cap Guardian portfolio which we are transitioning out of.

* The Employer reserve was at $481 million at 1/31/02. That times 8% is $38.5 million, leaving at best $4.5 million for the Employee reserve. Fiduciary counsel has advised that the way the Muni Code is structured, we have to credit Employer, Employee and DROP reserves at 8% and pay the budget regardless of the availability of earnings. That means expending assets — Employee, about $22.5 million, DROP, about $6 million, budget about $21 million, total about $49.5 million, or 1% to 2% reduction of the funding ratio.

* I hope I'm wrong, but projections of the value of assets lead me to believe that actuarial losses on investments could be nearly twice as much this year over last year. That could be a reduction in the funding ratio of 7%, if all else is equal. Those two things, without any other actuarial losses or additions to liabilities for new benefits, etc. put us at about 80%. Not a happy situation.

* There are some one time "fixes" that we can consider, such as tranferring outside assets back into System assets, but I don't know what to offer past that.

* I am trying to figure out a plan that will take the emphasis off of earnings as currently defined as a means of funding benefits. I need to know what the actual requirements are for establishing reserves, crediting and charging those reserves, etc. Can you point me in the right direction (except out of town)???

Like I said, don't shoot the messenger.
Larry

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

	89.9
— 5m error	< .9 >
— FY01 earnings solution	< 2.0 >
— FY02 earnings	< 7.0 >
— m+c 40m	< 6.5 >
ratio	73.5

FY00 97%
01 89%
02 79%
03 73

EXHIBIT # 15

TW Box 52 19/30

From: Terri Webster
To: Cathy Lexin
Subject: funding ratio

4-26-02

Cathy
I recall you mentioning that Larry said we'll be at a 84-86% funding ratio at 6-30-02. That makes no sense! I recommend not mentioning that especially on Monday since we're getting different stories. I have an email from Larry, less than two weeks ago which projected it to be at 80% on 6-30-02...the big drop (7% ?) will be due to FY 02 poor investment growth as well as a 1-2% loss due to the FY02 earnings solution.....so it makes no sense to me to now hear 84% .
(Also we're at 89.0% not 89.9% since the actuary mistakenly gave us credit for $5.8 million of port money.)

I think I also mentioned to you that Rick has purchase of service members payments (assets) in his formula but not the liability for additional years of service because CERS staff said they didn't have that information. Now MBS does have that information in it so for the 6-30-02 review the City once again will get another shocker! I would like to hear Larry's take on that. (I would push to factor it in over 3 years versus a one time hit).

On Friday, I did ask Rick if the Board could smooth out over 3-5years the $32.2m loss in this year's actuary report
(p. 10), that is due to CERS staff providing bad data over the years....he said yes, the Board has history of doing phase ins on at least 2 other occasions so I was hoping to discuss this with you before the next Board meeting and wrap it in the motion to accept the report ....that should help 1% or so but would still not likely get us above the trigger.

Let me know if you need more info

EXHIBIT # 16

Mail

Close

Previous Next

From: Terri Webster
To: Grissom, Lawrence
CC:
Date: 5/20/2002 10:26 AM
Subject: Re: Curmudgeon speaks

For the record, to my knowledge, the people working on this like myself, Holly, Bob, Dan, Paul..... get no better benefit under "Paul's or Holly's" version that the original draft/your write up..... so the statement "pad your own benefits " is wrong.

We're looking at what is fair and reasonable and thinking of the General Members as a whole versus individually. If their is a specific "hole" or "risk" in the theory that you see as the Retirement Administrator, please let Cathy/Dan/all know immediately because at this point no one has stated any problems with "Paul's/Holly's" proposed solution in terms of "detriment/harm/risk" to the system, the City, or the members.

Terri

>>> Lawrence Grissom 05/20/02 10:03AM >>>
Terri
so what's wrong with a minority opinion??

This was simply my attempt to deal with the concept in the original "Draft". If, after being accused of violating everything and further attempting to "pad" your own benefits, you guys feel you get another bite at the apple, go for it. I did not read Cathy as being at all amenable to changing the basic concept. If she did, then great! I honestly don't care how we do it, so long as everyone is on the same page. No desire to move backward on my part. You can't move backward until you've gotten somewhere in the first place.
Larry

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

>>> Terri Webster 05/17 5:25 PM >>>
Why is this still out there? The maker of the "deal" Cathy/Dan, clearly clarified that DRAFT language is not binding and if there is a better way to do implement a 90% cap and the 2.5 at 55 that meets the City, union, members, and CERS needs.... then Fine , we're not stuck with the old language.

I thought we were now all working on the same project of fine tuning that solution...hence "Paul and Holly's" versions that just need some tweaking on Monday....we're almost there.....

Again...why is Cathy's intent still being questioned and desires to move backwards are expressed?

Have a good weekend

Terri

EXHIBIT # 17

CALIFORNIA CONSTITUTION
ARTICLE 16 PUBLIC FINANCE

SEC. 17. The State shall not in any manner loan its credit, nor shall it subscribe to, or be interested in the stock of any company, association, or corporation, except that the State and each political subdivision, district, municipality, and public agency thereof is hereby authorized to acquire and hold shares of the capital stock of any mutual water company or corporation when the stock is so acquired or held for the purpose of furnishing a supply of water for public, municipal or governmental purposes; and the holding of the stock shall entitle the holder thereof to all of the rights, powers and privileges, and shall subject the holder to the obligations and liabilities conferred or imposed by law upon other holders of stock in the mutual water company or corporation in which the stock is so held.

Notwithstanding any other provisions of law or this Constitution to the contrary, the retirement board of a public pension or retirement system shall have plenary authority and fiduciary responsibility for investment of moneys and administration of the system, subject to all of the following:

(a) The retirement board of a public pension or retirement system shall have the sole and exclusive fiduciary responsibility over the assets of the public pension or retirement system. The retirement board shall also have sole and exclusive responsibility to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries. The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.

(b) The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system 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. A retirement board's duty to its participants and their beneficiaries shall take precedence over any other duty.

(c) The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims.

(d) The members of the retirement board of a public pension or retirement system shall diversify the investments of the system so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so.

(e) The retirement board of a public pension or retirement system, consistent with the exclusive fiduciary responsibilities vested in it, shall have the sole and exclusive power to provide for actuarial services in order to assure the competency of the assets of the public pension or retirement system.

(f) With regard to the retirement board of a public pension or

EXHIBIT # 18

retirement system which includes in its composition elected employee members, the number, terms, and method of selection or removal of members of the retirement board which were required by law or otherwise in effect on July 1, 1991, shall not be changed, amended, or modified by the Legislature unless the change, amendment, or modification enacted by the Legislature is ratified by a majority vote of the electors of the jurisdiction in which the participants of the system are or were, prior to retirement, employed.

(g) The Legislature may by statute continue to prohibit certain investments by a retirement board where it is in the public interest to do so, and provided that the prohibition satisfies the standards of fiduciary care and loyalty required of a retirement board pursuant to this section.

(h) As used in this section, the term "retirement board" shall mean the board of administration, board of trustees, board of directors, or other governing body or board of a public employees' pension or retirement system; provided, however, that the term "retirement board" shall not be interpreted to mean or include a governing body or board created after July 1, 1991 which does not administer pension or retirement benefits, or the elected legislative body of a jurisdiction which employs participants in a public employees' pension or retirement system.

CALIFORNIA CONSTITUTION
ARTICLE 16 PUBLIC FINANCE

SEC. 18. (a) No county, city, town, township, board of education, or school district, shall incur any indebtedness or liability in any manner or for any purpose exceeding in any year the income and revenue provided for such year, without the assent of two-thirds of the voters of the public entity voting at an election to be held for that purpose, except that with respect to any such public entity which is authorized to incur indebtedness for public school purposes, any proposition for the incurrence of indebtedness in the form of general obligation bonds for the purpose of repairing, reconstructing or replacing public school buildings determined, in the manner prescribed by law, to be structurally unsafe for school use, shall be adopted upon the approval of a majority of the voters of the public entity voting on the proposition at such election; nor unless before or at the time of incurring such indebtedness provision shall be made for the collection of an annual tax sufficient to pay the interest on such indebtedness as it falls due, and to provide for a sinking fund for the payment of the principal thereof, on or before maturity, which shall not exceed forty years from the time of contracting the indebtedness.

(b) Notwithstanding subdivision (a), on or after the effective date of the measure adding this subdivision, in the case of any school district, community college district, or county office of education, any proposition for the incurrence of indebtedness in the form of general obligation bonds for the construction, reconstruction, rehabilitation, or replacement of school facilities, including the furnishing and equipping of school facilities, or the acquisition or lease of real property for school facilities, shall be adopted upon the approval of 55 percent of the voters of the district or county, as appropriate, voting on the proposition at an election. This subdivision shall apply only to a proposition for the incurrence of indebtedness in the form of general obligation bonds

Mail

Close

Previous Next

From: Mike McGhee
To: Ryan, Ed; Webster, Terri; Kelley, Dan
CC: Lawrence, Bob; Wilson, Bob; Heap, Elmer
Date: 5/21/2002 9:42 AM
Subject: Re: Meet and Confer Update - Changes for FY 2003 / FY 2004 / FY 2005

Dan shared with me your comments Terri. I assure you that Ron is well aware of the contingent nature of the benefits, after our repeated statements at the negotiations table regarding the benefits being contingent upon your noted approvals. Cathy was very specific on those points at every discussion. The various proposals are all specific to the necessary approvals and available funding from the reserves, although this is not stated in this "highlights" to the departments.

>>> Terri Webster 5/21/02 9:22:50 AM >>>
Dan
The Local 145 write up you sent out did not state that their increased offset was contingent on the Board laxing the trigger .....I thought ALL retirement improvements (including the presidetial leave (?)) were contingent on the trigger.... especially need Ron behind releasing the trigger since he runs the show at CERS...

>>> Dan Kelley 05/21/02 08:27AM >>>
We are starting the Retirement Offsets with the first full pay period in the Fiscal Year.

We are going to talk to you on Presidential Leave and "Grandparenting" of 2.5% @ 55.

We are scheduling an implementation with your staff, Personnel and the Attorney's for this week.

Further discussion required on Direct Deposit and "Modified Agency Shop".

Local 127 has until this Friday to let us know if they want the "Modified Agency Shop" and the Direct Deposit.

Dan

>>> Ed Ryan 5/20/02 5:50:51 PM >>>
Dan, the Bob's thought they heard one of your staff say the retirement pickup started in the first full pay period of July. This seems to say different. Which is it? Also , is this the language you are proposing for Presidential Leave? I thought that the Attorney , you and I were going to discuss that.

>>> Dan Kelley 5/20/2002 5:37:58 PM >>>
Please share this information with your Executive Management Teams only.

Dan Kelley
Labor Relations Manager

EXHIBIT # 19

BLUE RIBBON COMMITTEE REPORT ON CITY OF SAN DIEGO FINANCES

27 Feb 2002 Rules Committee

FEBRUARY 2002

EXHIBIT # 20

BLUE RIBBON COMMITTEE REPORT
ON
CITY OF SAN DIEGO FINANCES
TABLE OF CONTENTS

Executive Summary — Page No.

Background 2

Objectives 3

Findings and Recommendations 5

Conclusion 10

Summary of Recommendations 12

Major Fiscal Areas

I. General Reserves and Insurance 13

II. Long Term Debt 15

III. Retirement Benefits and Unfunded Pension Liabilities 20

IV. General Deferred Maintenance and Unfunded Procurement 24

V. Water, Wastewater, Storm Water and Multiple Species Conservation Program 28

VI. Revenues and Expenditures 36

VII. Principles of Budgeting and Finance 38

Attachments

1. City of San Diego Achievements
2. Moody's California Cities Ratings
3. Moody's The Nation's Cities Ratings
4. Long Term Debt Analysis
5. Debt Service Analysis
6. General Fund Revenue Per Capita
7. General Fund Expenditures Per Capita

EXECUTIVE SUMMARY

BACKGROUND

In Mayor Dick Murphy's January 8, 2001 State of the City Address entitled "A Vision for San Diego in the Year 2020: A City Worthy of our Affection", he outlined ten goals for the City to focus on over the next four years. A concern raised by the Mayor was whether the City could afford to do the ten goals. As a result, Mayor Murphy announced he would convene a Blue Ribbon Committee on City Finances to perform an independent evaluation on the City's current fiscal health and make any appropriate recommendations. Furthermore, the Mayor stated that he would ask the City's independent Auditor and Comptroller Ed Ryan to provide staff support to the Committee. On April 27, 2001, the Mayor announced the following nine appointments to the Blue Ribbon Committee.

Members of Blue Ribbon Committee on City Finances

- **Joe Craver-Chair**
  President and Chief Executive Officer
  Galaxie Management, Inc.

- **April Boling-Vice Chair**
  Certified Public Accountant

- **Mary Ball**
  President, San Diego County Taxpayers Association

- **William McCurine, Jr.**
  Attorney, Partner
  Solomon, Ward, Seidenwurm & Smith, LLP

- **Andrew Poat**
  Former Chief Deputy Director, CALTRANS

- **April Riel**
  Certified Public Accountant, Certified Fraud Examiner, MPA

- **Victor Vilaplana**
  Attorney, Seltzer Caplan McMahon Vitek

- **Richard Vortmann**
  President, National Steel and Shipbuilding Company (NASSCO)

- **Linc Ward**
  Chair, Zero-Based Management Review (ZBMR) of the Select Committee

Staff support to the Blue Ribbon Committee included Ed Ryan, City Auditor and Comptroller, Terri Aja Webster, Assistant City Auditor and Comptroller, and Marian Thompson, Executive Secretary.

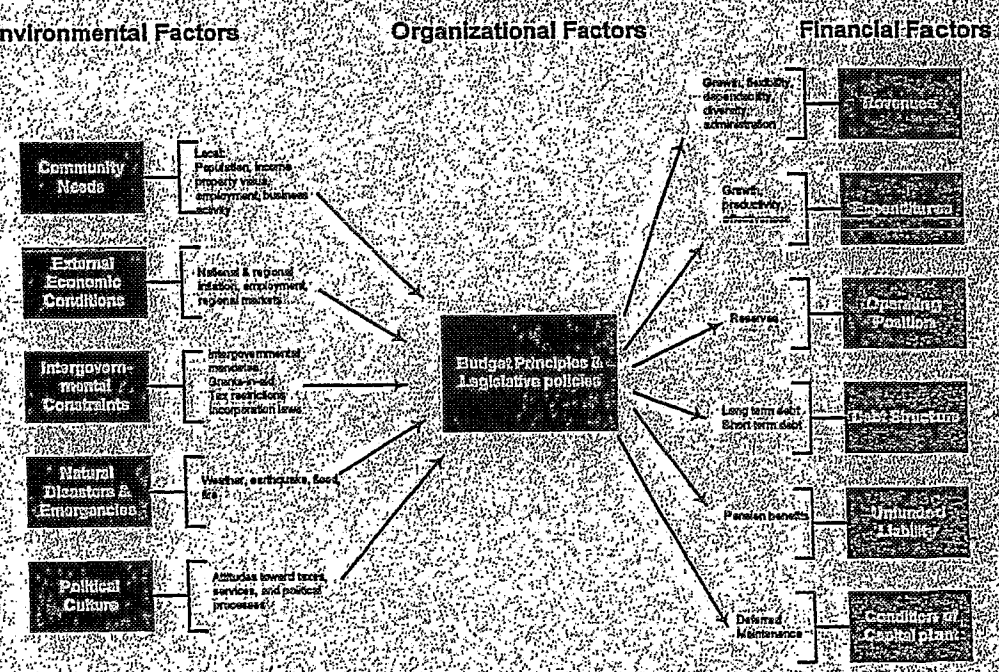
OBJECTIVES

The objectives of the Blue Ribbon Committee on City Finances were as follows:

- *Perform an independent evaluation of the fiscal health of the City of San Diego;*
- *Review the budgeting principles of the City of San Diego, and*
- *Report findings and recommendations to Mayor Dick Murphy.*

The term "*fiscal health*" refers to the City's ability to maintain existing service levels, withstand local and regional economic disruptions, and meet the demands of natural growth, decline, and change. In evaluating the City's fiscal health, the Committee began by defining and evaluating a variety of financial and economic indicators and obtaining an understanding of the fiscal process. Requests were made to City staff to provide specific financial information, some of which are included in the attachments to this report. In addition, members of the Committee met with the City Manager who provided an overview of the annual budget process and the financial policies and procedures.

During this stage the Committee identified many indicators, which directly or indirectly affect the fiscal health of the City. These indicators were either environmental, organizational, or financial. Environmental factors such as population, unemployment, recession, and natural disasters are all non-controllable factors, which externally influence the City by creating demands and providing resources. This has a direct effect on organizational factors such as management practices and legislative policies. How well the City follows and addresses its budgeting principles relates directly to how well the City is responding to environmental factors. Finally, the financial factors reflect the condition of the City's finances, which is the primary focus of our report. Below is an illustration of the factors affecting the fiscal health of the City:



III. Retirement Benefits and Unfunded Pension Liabilities

The Committee is very concerned that the City is not paying out of its current year's budget the full cost being incurred by its current workforce for their future pension and retiree health benefits. The City is not paying approximately $6-8 million a year for future pension benefits. As a result, a portion of the cost of today's City workforce will be paid by future year's taxpayers. Further, this non-discretionary item in the budget has been growing steadily and will continue to grow in the future.

Recommendation 2: Change the City's funding strategy to one that results in the City fully funding its future obligations earned today which includes the pension benefits as well as health benefits.

Recommendation 3: Obtain a current and comprehensive analysis of projected pension expenses and revenue sources, which includes the current present value of retiree health benefits to determine the impact on future City finances.

IV. General Deferred Maintenance and Unfunded Procurement

The Committee estimates the City's unfunded deferred maintenance to be in excess of $300 million in the areas of Streets, Alleys, Sidewalks, Street Light and Traffic Signals, Bridges, Buildings and Structures, Fleet, and Coastal Infrastructure and Facilities. Information provided to the Committee was preliminary or inconsistent with other reports obtained by the Committee. As a result, the Committee was unable to accurately quantify the backlog of unfunded deferred maintenance. The Committee believes, however, that the current level of funding is not reducing the backlog and is, instead, contributing to its increase.

The Committee was advised that the City has approximately $170 million in Information Technology needs which is mainly unfunded procurement. These Information Technology needs result from a combination of technology improvement and early anticipation of future needs over the next 2-5 years.

Recommendation 4: The City Manager should establish a process so that all deferred maintenance and unfunded procurement information is developed, aggregated, consistent, complete, non-duplicative, rated for priority, and is available on call for budgetary decisions.

Recommendation 5: The City Manager should prepare and present a public report during the annual budget hearings identifying the cumulative deferred maintenance backlog and unfunded procurement needs which includes asset descriptions, dollar requirements, and categorized by level of need with funding sources.

Recommendation 6: The City's policy with respect to funding deferred maintenance and Information Technology procurement should be revised to increase expenditures in these crucial areas. While the Committee notes some improvement in addressing deferred maintenance needs in some specific areas, other areas continue to deteriorate.

CONCLUSION

The City is basically fiscally sound. San Diego operates within a restricted revenue base, its revenues per capita are lower than most major cities in the United States. San Diego operates within the restrictions of the Peoples Ordinance-adopted in a different era which precludes the collection of fees for residential trash collection. The City does not utilize some revenue sources such as Utility User Tax, Residential Trash Collection Fees, and Water/Sewer Utility Right-of-Way fee used by other California cities to offset the restrictions of Proposition 13.

San Diego, as with any governmental entity, has fiscal demands, which exceed current funding sources. While other cities have entered into higher levels of debt, San Diego has maintained an acceptable level of debt, and as a result has retained a positive credit rating over the years. Over the next few years, the City proposes increases in debt. These increases are planned to be mitigated by growth in existing revenue sources such that debt service as a percentage of revenues is only increasing by less than 1 percentage point.

However, there are some serious concerns, which the Committee felt needed to be brought into full focus and addressed by the City Council. These issues were long in their creation and certainly were not the product of the current City leaders. Nonetheless the incumbent Administration must publicly recognize the issues and develop to a plan deal with them.

First and foremost, operating within the restrictions identified above, decisions have been made over the years to defer physical infrastructure requirements in favor of more visible or other pressing needs. While this is a difficult issue to accurately quantify, City staff estimates unfunded deferred maintenance exceeds $300 million. Deferred maintenance is a somewhat illusive issue in that reasonable people can differ on what is truly "needed" versus what is "nice to have". Similarly with Information Technology, what is truly needed in this rapidly changing world versus what is truly cost justified is often debated. But in any event, the City must visibly acknowledge this serious problem, accurately quantify it, and develop a financial plan to remedy the problem over a specified period of time.

The second concern is that, analogous to the "deferred maintenance", the City is likewise partially deferring until later years the recognition of currently incurred cost for pensions and retiree health benefits (i.e. earned by current employee to be collected in later years). The City is not having current year's taxpayers pay for all the pension and retiree health benefit costs that are earned in that year. This is placing a growing burden on future years' taxpayers.

Third, the City has been prudent over the last five years in recognizing the need for a reserve for unplanned "crises". As a result, reserves have gradually been built over the last few "boom" economic years, but the magnitude of it is still significantly less than other municipalities find prudent. The Committee encourages the City to continue to build these reserves up to at level of 7-10% of General Fund Revenues.

A further concern is the current economic conditions both locally and statewide. The current recession can have a material impact on City revenue in the near term. This means a concerted effort must be made now to control expenses and further improve operating efficiencies.

The Committee feels it is incumbent on the City to develop a long range financial and operations plan to address the issues raised in this report and to fully apprise the public of the issues and of the plans. It is anticipated that the financial plan would include a combination of increasing the current revenue base, obtaining additional revenue sources, and controlling/reducing expenditures.

Finally, the Committee requests that the City respond to the recommendations contained in this report in March of 2003, at which date, the Blue Ribbon Committee will reconvene to evaluate the City's progress on each recommendation.

In conclusion, the Committee believes San Diego has earned the self-proclaimed title of America's Finest City and that the City is poised to perpetuate that title. How well the City deals with the issues raised in this report will play heavily in how deserved that title will be in the future as well as the Mayor's goal of being a *"City worthy of our affection."*

BLUE RIBBON WORK PLAN

May 11,2001	Foundation meeting to review and agree on our objectives and work plan
May 25, 2001	Defined presentations and/or information we need for City staff
June 1, 2001	Strategic Plan presentation and discussion Assignment of task items
June 15, 2001	Criteria for evaluating the Fiscal Health of the City of San Diego
June 22, 2001	Planning presentation, discussion, recommendations Review "vision" draft (Review progress or cancel)
July 13, 2001	Key revenue sources and trends presentation Discussion of revenue recommendations Review "Planning" draft, assign tasks
July ~~20~~ 27, 2001 1:00	Budgeting process presentation • Transparent/knowledgeable • Contingencies Discussion of budgeting recommendations Review revenue base draft (Review progress or cancel)
Aug 3, 2001	Sound cost management and performance evaluation Accounting and performance evaluation presentation Discussion of accounting and accountability recommendations Review budgeting process draft
Aug 17, 2001	Sound debt, cash management and related policies Debt policy, cash management presentation Discussion of debt/cash management recommendations Review "Cash Management and Performance Evaluation" draft
Sep 7, 2001	Final review of Task Force Report Present report to Mayor

Cancel 7/20
HAVE OUTLINES

EXHIBIT # 21

THE COMMITTEE ON
RULES, FINANCE AND INTERGOVERNMENTAL RELATIONS
OF THE CITY COUNCIL OF THE CITY OF SAN DIEGO
(MAYOR DICK MURPHY, CHAIRPERSON)

Agenda for Meeting at 9:00 am
Wednesday, February 27, 2002

COUNCIL COMMITTEE MEETING ROOM (12TH FLOOR)
202 C STREET, SAN DIEGO CALIFORNIA

(FOR INFORMATION, CONTACT BILL BABER,
COMMITTEE CONSULTANT, AT 619-236-6330)

- ❑ **PUBLIC COMMENT**
- ❑ **REQUESTS FOR CONTINUANCE**
- ❑ **CONSENT AGENDA**
- ❑ **ADOPTION AGENDA**

❑ ITEM-1: Discussion re: Report from the Mayor's Blue Ribbon Committee on Budget and Finance. (Approx. 90 minutes)

❑ ITEM-2: Discussion re: San Diego's Proposed Urban Forest. (Continued from the January 23, 2002, meeting.) (Approx. 45 minutes)

❑ ITEM-3: Discussion re: Proposal to amend Municipal Code Section 35.0111 to reflect an increase in the room rental charge amount exempt from Transient Occupancy Tax (TOT) from $20 per night to $25 per night. (Approx. 30 minutes)

❑ **ADJOURNMENT**

Important Public Information Regarding this Meeting **DIAL-A-COUNCIL:**

The City Clerk's office has implemented Dial-A-Council to enable the public, City officials, and staff to listen to the Council Committee meeting while it is in progress. To listen to the Committee meeting, dial 533-4001 beginning at the noticed time of this meeting. Note:

EXHIBIT # 22

Rancho Bernardo and Rancho Peñasquitos residents dial 484-7711 and ask the Citizen's Assistance operator to connect you to Dial-A-Council.

INTERNET ACCESS TO COMMITTEE AGENDAS: The Internet address is: http://www.sandiego.gov

ACCESS FOR PEOPLE WITH DISABILITIES: This information is available in alternative formats upon request. To request an agenda in braille, large print, cassette or to request a sign language or oral interpreter for the meeting, call the City Clerk at least five (5) working days prior to the meeting to insure availability. ALD's are available from the City Clerk's office prior to the meeting and are to be returned at the end of the meeting.

COUNCIL COMMENT: Committee Members may make brief announcements or give a brief report on matters not on the agenda. Additionally, non-Committee Councilmembers may appear and address the Committee on any agenda item, although non-Committee members may not deliberate or vote on such matters.

If a **COMMUNICATION REQUEST FORM** is submitted to the City Clerk seven (7) calendar days prior to the Committee meeting, the matter may be placed on the agenda as a scheduled communication and the Committee may discuss the item prior to its appropriate disposition.

COMMENT ON NON-AGENDA ITEMS: Any member of the public may address the Committee on any subject in its area of responsibility on any matter not presently pending or previously discussed at the Committee. Comments are limited to three (3) minutes and are non-debatable. At the conclusion of the comment, the Committee Chair shall have the discretion to determine appropriate disposition of the matter. Comments on non-agenda items will be heard immediately preceding the regularly scheduled business of the Committee. To exercise this right, members of the public wishing to address the Committee under "Non-Agenda Items" must submit a "Non-Agenda Comment Request" form prior to the meeting. Subject matter and time limitations are noted on the form. Pursuant to open meeting laws, no discussion or action, other than a referral, shall be taken by the Committee on any issue brought forth under "Non-Agenda Comment."

CONSENT AGENDA: The Chair may entertain a motion by a Committee Member to approve certain noncontroversial agenda items as consent agenda items at the beginning of the meeting.

THE COMMITTEE ON
RULES, FINANCE AND INTERGOVERNMENTAL RELATIONS
OF THE CITY COUNCIL OF THE CITY OF SAN DIEGO
(MAYOR DICK MURPHY, CHAIRPERSON)

Agenda for Meeting at 9:00 am
Wednesday, March 20, 2002

COUNCIL COMMITTEE MEETING ROOM (12TH FLOOR)
202 C STREET, SAN DIEGO CALIFORNIA

(FOR INFORMATION, CONTACT BILL BABER,
COMMITTEE CONSULTANT, AT 619-236-6330)

- ❑ **PUBLIC COMMENT**
- ❑ **REQUESTS FOR CONTINUANCE**
- ❑ **CONSENT AGENDA**
- ❑ **ADOPTION AGENDA**

❑ ITEM-1: Discussion re: City Manager's Response to the recommendations made by the Mayor's Blue Ribbon Committee on Budget and Finance. (Approx. 60 minutes)

❑ ITEM-2: Discussion re: City Manager's Energy Conservation and Management Status Report No.10 (including but not limited to a discussion of the U.S. Green Building Council's Leadership in Energy and Environmental Design Standard). (Approx. 60 minutes)

❑ ITEM-3: Discussion re: Airport Authority Legislation. (Approx. 30 minutes)

❑ **ADJOURNMENT**

Important Public Information Regarding this Meeting

DIAL-A-COUNCIL: The City Clerk's office has implemented Dial-A-Council to enable the public, City officials, and staff to listen to the Council Committee meeting while it is in progress. To listen to the Committee meeting, dial 533-4001 beginning at the noticed time of this meeting. Note: Rancho Bernardo and Rancho Peñasquitos residents dial 484-7711 and ask the Citizen's Assistance operator to connect you to Dial-A-Council.

INTERNET ACCESS TO COMMITTEE AGENDAS: The Internet address is: http://www.sandiego.gov

ACCESS FOR PEOPLE WITH DISABILITIES: This information is available in alternative formats upon request. To request an agenda in braille, large print, cassette or to request a sign language or oral interpreter for the meeting, call the City Clerk at least five (5) working days prior to the meeting to insure availability. ALD's are available from the City Clerk's office prior to the meeting and are to be returned at the end of the meeting.

COUNCIL COMMENT: Committee Members may make brief announcements or give a brief report on matters not on the agenda. Additionally, non-Committee Councilmembers may appear and address the Committee on any agenda item, although non-Committee members may not deliberate or vote on such matters.

If a **COMMUNICATION REQUEST FORM** is submitted to the City Clerk seven (7) calendar days prior to the Committee meeting, the matter may be placed on the agenda as a scheduled communication and the Committee may discuss the item prior to its appropriate disposition.

COMMENT ON NON-AGENDA ITEMS: Any member of the public may address the Committee on any subject in its area of responsibility on any matter not presently pending or previously discussed at the Committee. Comments are limited to three (3) minutes and are non-debatable. At the conclusion of the comment, the Committee Chair shall have the discretion to determine appropriate disposition of the matter. Comments on non-agenda items will be heard immediately preceding the regularly scheduled business of the Committee. To exercise this right, members of the public wishing to address the Committee under "Non-Agenda Items" must submit a "Non-Agenda Comment Request" form prior to the meeting. Subject matter and time limitations are noted on the form. Pursuant to open meeting laws, no discussion or action, other than a referral, shall be taken by the Committee on any issue brought forth under "Non-Agenda Comment."

CONSENT AGENDA: The Chair may entertain a motion by a Committee Member to approve certain noncontroversial agenda items as consent agenda items at the beginning of the meeting.

* ITEM-104: National Fair Housing Month 16

* ITEM-105: Institute on World Affairs Day 17

* ITEM-106: Dr. Mary Frances Berry Day 17

* ITEM-107: Settlement of the Personal Injury Claim of Lia Adkins 18

8 ITEM-108: Agreement with MPI for Construction Support Services for Alvarado WTP Upgrade and Expansion - Phase II. 19

* ITEM-109: Lease Approval - Torrey Hills YMCA 21

* ITEM-110: Lease Approval - La Jolla YMCA 22

* ITEM-111: Angle Parking on Canon Street, Upshur Street, Talbot Street and Scott Street 23

ITEM-112: Roof Replacements - Police Headquarters and Northern Area Station 24

* ITEM-113: Consultant Selection/Brown Field Airport Slurry Seal and Paint All Runways and Taxiways 26

* ITEM-114: Amending FY2002 Capital Improvements Program - Kumeyaay Lake Berm Replacement 28

ITEM-150: Recommendations Made by the Mayor's Blue Ribbon Committee on Budget and Finance 30

ITEM-250: Settlement of Property Damage Claim of CFD Mesa Ridge Partners Claim 32

*ITEM-S400: San Diego's Sister City of Vladivostok, Russia and Mayor of Vladivostok, Yuri V. Kopylov 33

ITEM-S401: Two actions related to the City of San Diego Youth Commission 34

*ITEM-S402: Appointments to the San Diego Data Processing Corporation Board of Directors 36

ADJOURNMENT 37

Herring/DVW

Aud. Cert. 2200854.

FILE LOCATION: MEET

COUNCIL ACTION: (Tape location: A338-469.)

CONSENT MOTION BY STEVENS TO ADOPT. Second by Madaffer. 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-150: Recommendations Made by the Mayor's Blue Ribbon Committee on Budget and Finance.

(See City Manager Report CMR-02-061 and Mayor Murphy's 3/20/2002 memo.)

TODAY'S ACTION IS:

Adoption of the following resolution:

(R-2002-1385 Cor. Copy) ADOPTED AS RESOLUTION R-296354

Accepting the Blue Ribbon Committee Report on City of San Diego Finances, dated February 2002;

Accepting City Manager's Report CMR-02-061, dated March 18, 2002;

Adopting the schedule in the Mayor's April 4, 2002 memo.

RULES, FINANCE AND INTERGOVERNMENTAL RELATIONS COMMITTEE'S RECOMMENDATION:

On 3/20/2002, RULES voted 4-0 to accept City Manager's Report CMR-02-061 and adopt the items in the Mayor's March 20, 2002 memo with the following two changes to the Mayor's memo: a) Line 5, add "Would include a discussion of limiting City employee growth to the rate of population growth except when we add a program.", b) Line 6, add "Would include a discussion of the 2/3 vote requirement to make a mid-year budget modification."

(Councilmembers Wear, Atkins, Stevens and Mayor Murphy voted yea. Councilmember Madaffer not present.)

FILE LOCATION: MEET

COUNCIL ACTION: (Tape location: B145-E056.)

MOTION BY FRYE TO ADOPT THE RESOLUTION, ACCEPTING THE BLUE RIBBON COMMITTEE'S REPORT EXCEPT FOR SECTION V, WITH DIRECTIONS TO THE CITY MANAGER THAT SECTION V CONCERNING STORM WATER BE RETURNED TO THE RULES COMMITTEE FOR DISCUSSION, RATHER THAN ADOPTING IT AS PART OF THE REPORT. AND TO PROVIDE A REPORT OF A LARGER ANALYSIS FOR EACH OF THE FOUR SECTIONS, CITING SPECIFICALLY THE LANGUAGE ON PAGES 33 AND 34. IN ADDITION, ADOPT ALL OF THE RULES COMMITTEE'S RECOMMENDATIONS AS SET FORTH IN THE MAYOR'S MEMO. AS TO RECOMMENDATION 1, ADOPT THE RULES COMMITTEE'S ACTION TO APPROVE THE FIRST SENTENCE ONLY. FOR RECOMMENDATIONS 2 AND 3, REFER THESE TO THE RETIREMENT BOARD BY JUNE 30, 2002. ADOPT RECOMMENDATION 7 WITH THE CITY MANAGER'S PROPOSAL TO GO TO THE RULES COMMITTEE BY SEPTEMBER 30, 2002, TO INCLUDE A DISCUSSION OF THE RIGHT-OF-WAY FEES. CONCERNING RECOMMENDATION 8, THE CITY MANAGER'S PROPOSAL SHOULD GO TO THE RULES COMMITTEE BY OCTOBER 31, 2002, TO INCLUDE THE DISCUSSION OF LIMITING CITY EMPLOYEE GROWTH TO THE RATE OF POPULATION GROWTH EXCEPT WHEN PROGRAMS ARE ADDED AND AFTER A BASE IS DETERMINED. THE PHRASE "AND AFTER A BASE IS DETERMINED" SHOULD BE ADDED ON LINE 5 AFTER THE PHRASE "WHICH WOULD INCLUDE A DISCUSSION OF LIMITING THE CITY EMPLOYEE GROWTH TO THE RATE OF POPULATION GROWTH EXCEPT WHEN WE HAD A PROGRAM." AS TO RECOMMENDATION 9, REQUEST THAT THE CITY MANAGER'S PROPOSAL GO TO THE RULES COMMITTEE BY NOVEMBER 30, 2002, WHICH SHOULD INCLUDE A DISCUSSION OF A TWO-THIRDS VOTE THAT WOULD BE REQUIRED TO PROVIDE A MID-YEAR BUDGET MODIFICATION.

ACCEPT COUNCIL MEMBER WEAR'S RECOMMENDATION THAT AN EXAMINATION OF THE ISSUE OF CHARGING FEES AND COLLECTING A FAIR SHARE FROM CITIZENS OF OTHER CITIES FOR CITY SERVICES BE SPECIFICALLY ADDED TO THE RULES COMMITTEE ACTION IN SECTION VII UNDER REVENUES. THIS SHOULD INCLUDE A DISCUSSION OF HOW NEW

GROWTH MAY OR MAY NOT BE SUBSIDIZED BY THE EXISTING USERS, PARTICULARLY AS IT RELATES TO WASTE WATER AND WATER SUPPLY.

ACCEPT COUNCIL MEMBER PETERS' RECOMMENDATION THAT THE ISSUE OF REFINANCING THE CITY'S DEBT BE EXAMINED WITH A VIEW TO POTENTIAL SAVINGS IN DEBT SERVICE. IN ADDITION, THERE SHOULD BE AN EXAMINATION OF TOBACCO FUNDS WITH A VIEW TO RECEIVING UP-FRONT PAYMENT. Second by Peters. 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-250: Settlement of Property Damage Claim of CFD Mesa Ridge Partners Claim.

(R-2002-1228)

Adopted as Resolution R-296254.

A Resolution approved by the City Council in Closed Session on Tuesday, April 2, 2002, by the following vote: Peters-not present; Wear-yea; Atkins-yea; Stevens-not present; Maienschein-yea; Frye-yea; Madaffer-yea; Inzunza-yea; Mayor-yea.

Authorizing the City Manager to pay the total sum of $95,989.04 in the settlement of each and every claim against the City, its agents and employees, resulting from property damage to CFD Mesa Ridge Partners on June 28, 2001;

Authorizing the City Auditor and Comptroller to issue one check for the balance of $46,692.04 made payable to Luth & Turley, Inc. in full settlement of all claims.

Aud. Cert. 2200917.

NOTE: This item is placed on a Council docket, so that the official and public record will reflect the adoption of this Resolution. It does not require any further Council action.

MAYOR DICK MURPHY

BLUE RIBBON COMMITTEE ON CITY FINANCES

Minutes of July 13, 2001 Meeting

Joe Craver, Chair of the Committee, opened the meeting at noon. Those attending were: Committee Members Joseph Craver, Mary Ball, Andrew Poat, Dick Vortmann, April Rose Riel, Linc Ward, April Boling, William McCurine and staff Ed Ryan and Terri Webster.

The June 22, 2001 Minutes were distributed along with reports from City staff that had been requested. This information had also been e-mailed to the Committee. The Chair stated that if members had not read the information, they should take the time to review it to help them with their assigned tasks. Staff distributed an updated Brainstorming list and April Riel's June 6 Request for Fiscal Criteria that reflected what has already been provided to the Committee.

The Chair stated the goal of the meeting was to assign each Committee member their responsibility(ies) needed to prepare the final report. He stated that there would be a written final report as well as an oral report. For the oral report the Chair will start and end the presentation and Committee members will cover their assigned portion. The Committee members will present their portions of the oral report at the next few meetings and a dry run of the formal oral presentation to the Mayor will be scheduled. April Riel offered to put the presentation in PowerPoint and provide the equipment needed.

The Brainstorming List (copy attached) has been updated to reflect committee assignments and the results of a lengthy discussion which categorized 6 items as critical to the report.
A new critical item added is called "Budgeting Principles" that would include the old item on "Library Ordinance". In the Chair's introduction and conclusion to the report he will cover the items on a need for a "Strategic Plan" and discussion about "Revenue and Expenses".

A discussion was held concerning giving recommendations as to other revenue sources which was in the Mayor's Proposed Scope of Activity for the Blue Ribbon Committee. After discussion, it was the consensus that the committee should not recommend new or expanded revenue sources or expenditure cuts since that is a policy issue for the elected officials.

EXHIBIT # 23

The following are the key assignments indicating the lead person and the members who have agreed to help on the issue:

Item No.	Lead	Members
1. Deferred Maintenance	April Boling	Linc (fleet replacement), Andrew (streets), Mary (IT)
2. Unfunded Pension Liability	Dick Vortmann	
3. Reserves	Mary Ball	William
5. Ability to Cope with Future Needs	Linc Ward	Dick, Andrew (MSCP)
6. Debt Service/Capacity	April Riel	Victor
7. Budgeting Principles	Andrew Poat	
Introduction and Conclusion	Joe Craver	William

The Chair reminded everyone that each member may be asked to assist on one of these items even though they may also be lead or a member of another item.

The Committee requested that staff provide information on office space including the percent of real estate leased; lease expiration schedule with dollar amounts; and current market value compared to actual lease payments.

The meeting adjourned at 1:20 p.m.

REMINDER: The July 20, 2001 meeting is canceled. The next meeting is **Friday, July 27, 2001, 1:00 p.m. to 2:30 p.m.** in the large conference room on the 7th floor of the **City Administration Building**. Lunch will be provided. **Dick Vortmann will give his report on Unfunded Pension Liability.**

FOR IMMEDIATE RELEASE
DATE: September 21, 2001

CONTACT: Elena Cristiano
619.236.7066
1ec@sdmayor.sannet.gov

Mayor Murphy Appoints Two to Retirement Board
City Council Confirms Vortmann and Garnica

San Diego- Mayor Dick Murphy today announced the City Council's confirmation of his appointees to the Retirement System, City Employees' Board of Administration–Richard Vortmann and Ray Garnica. The board determines the conditions under which city employees are admitted to the benefits of the retirement system, and controls administration and investment of retirement funds.

Vortmann, a member of the Mayor's Blue Ribbon Committee on City Finance, is the Vice President of General Dynamics and President of National Steel and Shipbuilding Company (NASSCO). He is a member of the Chamber of Commerce's CEO Roundtable and the Business and Economic Development Council of San Diego. He has served in various financial management positions with Kaiser Industries Corporation. Vortmann earned a bachelor's degree in Finance and a master's degree in Business Administration from the University of California, Berkley.

Garnica, who fulfills the officer of a local bank requirement, is the Vice President and Regional Manager at United California Bank. He is responsible for the bank's Wealth Management Division regionally, in particular the management and growth of the division's business units in the investment management, trust administration and corporate tax retirement planning fields. He is a member of the Mexican American Business and Professional Association (MABPA), the Corporate Directors Forum and Mainly Mozart Business Task Force. Garnica earned a bachelor's degree in Chemical Engineering and a master's degree in Finance from the University of Southern California.

###

close

THE CITY OF SAN DIEGO

EXHIBIT # 24

NATIONAL STEEL AND SHIPBUILDING COMPANY
A GENERAL DYNAMICS COMPANY

RICHARD H. VORTMANN
PRESIDENT

February 18, 2002

Mr. Frederick W. Pierce, IV **Via Fax: 619/583-5439**
Chairman – San Diego City Employee Retirement System
The Pierce Company, Inc.
5250 Campanile Drive
Fourth Floor
San Diego, CA 92182-1940

Dear Fred:

My reading of the new actuarial report raises several questions. Possibly some (or all) are due to my ignorance but I am concerned there are some significant issues buried here. I would respectfully request that staff address these to assure the full Board truly understands what is happening (or educate me separately if I'm the problem). I have copied Larry on this letter, but I am not sure of the protocol here.

SDCERS – Actuarial Report

Page Numbers	Question/Statement
i)	Who is the "Manager" referred to herein "Manager's Proposed Rates?"
1 & 2	This statement of philosophy is simple and direct. Unfortunately it is **not** being followed.
4	Funding objective is clearly stated. It is not being followed!
4	Contribution rates: Normal Cost + amortization of unfunded actuarial accrued liability = Total contribution Does "amortization" include both amortization of "principal" (i.e. unfunded balance) **plus** interest on the unfunded balance? Is it a level P & I payment or level P, plus interest on top of that?
4	Why the year gap – i.e. computed contributions as of 6/30/01 apply to FY beginning in 7/1/02. What actuarial rates apply to w/ years? lead time for budg
6	Why did contribution as % of payroll drop significantly in 01-02 (before Corbet settlement)?
6	What, when and why was "Mgr's Proposal"?

purpose? how well understood by successive regimes?

2798 HARBOR DRIVE • SAN DIEGO, CA 92113 • PO. BOX 85278 • SAN DIEGO, CA 92186-5278
TELEPHONE (619) 544-8600 • FAX (619) 544-3541 • E-MAIL: dvortman@nassco.com

EXHIBIT # 25

8 How is the City's "pick-up portion" of ee's contribution determined? Is this a "Meet and Confer" item." Is it different every year? – what part on w/ $8m?

10 Total accrued liabilities of $2.8B. What does this include?

- ✓Basic pension
- ✓Corbet
- ∅13th Check
- ∅Medical
- Etc.

10 Shows "Assets allocated to Funding" = $2,525,645,008

Which "reserves" and "contingencies", etc. does this include? (Reconcile with data on page 22.)

Why do we consider any of these as a reserve if the actuary assumes these dollars are available to cover accrued liabilities?

11 C. Present Value of expected future members contributions: is this the gross amount, or is it net of expected City's "pick-up" contribution:

If gross, does this not eventually result in a significantly understated liability for the City <u>if</u> the City is also going to pay some of ee's cost?

14 B. Why did Staff request this to be included as an asset to pay benefits? Why was the $105m contingency established if we now tell Actuary it is to be used for benefits?

Am I confused here? If not, this is a rather big issue – i.e. the $105m can't be used twice. A funded ratio at 85.6% is getting close to the 82.3% trigger where the current "unconventional" actuarial method is violated.
89.9% → 85.6% (if Reserve is a true reserve) → 83.1% (if Corbet not contingent)

(This note seems to answer in part my question on page 10 of what is in liabilities, i.e. Corbet is not. But it is really not a contingency? So why is it excluded?)

14 C. The "brewing storm cloud" needs to be fully explained. The 5 year smoothing will, I take it, carry '01's poor investment performance into future years.

14 C. How did "average compensation" increase 7.7%? What was the acknowledged general wage increase percentage? How does that reconcile with the 7.7%? How well is that understood at the City?

15 D. What impact will a change in assumed retirement age have? (Ball park estimates?)

15 E. Again this is a disturbing note. How will this "revisited assumption" impact the numbers?

15 F. What is the significance of the point being made here?

16 G. The actuary seems to be saying there should have been an adjustment to the "Mgr's Proposal" once Corbet happened. Was this addressed? Why didn't actuary force it.

16 H. What do these "adders" get added to? ditto

17 I. What is the significance of this "undercounting of the liability" due to purchased service credits? How significant? ditto

17 I. Why is the Actuary questioning the appropriation of the 2% COLA payment? ditto

17 J. What is the significance to the numbers of this statement?

17 L. What are the merits of transferring to an Entry Age Normal method? Does it really mean the City's contribution would be:

Mgr's Proposal	-	~~9.83%~~ 10.33%
PUC Actuary's number	-	15.59%
Entry Age Normal	-	17.75%

17 M. I get a very strong sense of "game playing" or anticipatory "ass covering" by the Actuary. This is most disturbing. How can they say the "system continues to be in sound condition in accordance with actuarial principles of level cost financing". The actual practice is **not** "level cost funding".

Sincerely,

Richard H. Vortmann
President

RHV/lh

cc: Larry Grissom **Via Fax: 619/533-4611**

24. Net applicable asset 2,341,407
+ 91,809 unrecognized gains
2,433,216
V. 2,525,695 pg. 50

Mail

Close

Previous Next

From: "Leilani Hughes" <lhughes@nassco.com>
To: TAA Auditor cab7-9
CC:
Date: 7/31/2001 11:27 AM
Subject: Questions for City Pension Manager
Attachments: City Pension Mgr Questions 073001.doc (22,528 bytes)
Mime.822 (33,363 bytes)

Ms. Webster,

Mr. Vortmann has asked that I send you the attached with the following note:

"Terri,

Thank you for your e-mailed comments.

Attached are the issues I'd like to discuss this afternoon along with any other comments you or Larry Grissom have on my draft "conclusions".

Basically, pending what more I can learn this afternoon, the only concluding judgment I feel our committee should make regarding the pension's impact on the Fiscal Health of the City is to assure the policy makers recognize that their annual cost for retiree benefits is most likely going to continue to rise at a more rapid rate than payroll. As long as this is comprehended in long term budget planning, then there is no big issue.

Dick"

R/Leilani

EXHIBIT # 26

R.H. Vortmann
8/30/01

Employee Retirement Benefit Liabilities

Employee retirement benefit liabilities of the City comprise two issues:

1. Pensions
2. Retiree Health Benefits

The City appears to have, relative to typical private industry standards, very generous benefits for retired employees. That in and of itself is a policy issue. The question here is how these benefit policies affect the fiscal health of the City. The issue of how the City's pension assets are invested, etc. is not addressed here.

The concern regarding Employee Retirement Benefit Liabilities is two fold: i) whether the City budget properly cash flow funds, each year, the current year's "expense" for the eventual cash payments for these retiree benefits which will be made many years later; and ii) whether the budgetary process properly reflects the apparently steadily growing annual expense obligation, particularly given the "uncontrollable – non-discretionary" nature of this liability.

The potential risk is that policy makers grant benefit improvements today (to satisfy employee concerns, to negotiate trade offs with unions, etc.), but avoid recognizing the actual annual cost of such by actuarially spreading the cost over years far out in the future, long after the individuals who made the policy decisions are gone. This is particularly acute where the retiree benefit improvements are granted "retroactively", i.e. new improved benefits which are applied to past, as well as future, years of service for active employees. This "retroactive" approach in general is the practice the City has pursued. Major Pension improvements were implemented in FY97 (227% increase) and in FY00 (another 12% as a result of a litigation settlement). San Diego County is in the final stages of approving major pension improvements, exceeding San Diego City benefits. This will undoubtedly lead to pressure for further increases for City employees.

The City's current annual cash expense for pensions is $66.0m (FY01). This is one of the larger line items in the City's overall budget. Further, this expense line item has been growing at about a 9% per year compound rate the last five years (and at a much faster rate if measured back 10 years).

EXHIBIT # 27

	Payroll Base (a)	Cash Contribution to Pension Trust Fund (b)	Cash Contribution As Percent of Payroll Base (b) / (a) [1]
FY92	$313m	$27.4m	8.8%
FY93	$321m	$31.2m	9.7%
FY94	$338m	$34.6m	10.2%
FY95	$351m	$38.6m	11.0%
FY96	$365m	$43.7m	11.9%
FY97	$383m	$47.5m	12.4%
FY98	$399m	$51.0m	12.8%
FY99	$425m	$55.4m	13.0%
FY00	$449m	$60.7m	13.5%
FY01 /Est.	$469m	$66.0m	14.1%

[a] Source: 6/30/00 Actuarial Report
[b] Source: Annual June 30 San Diego City Employees Retirement Trust Fund Financial Statements
[1] Resulting percentage varies from a actuarially mandated .5% per year increase due to varying amount of employee contributions paid for by the City.

From the above chart it is clear that annual pension budget expenses have been increasing faster than the underlying payroll base.

Additionally, the pension plan is not in a fully funded position. It has been at a 93% funded level for several years (i.e. its current assets equaled 93% of the actuarially computed present value of the future Pension Plan liabilities). While holding at the 93% level, the absolute dollar amount of under funding hit a peak of $148m in FY99. Excellent Pension asset investment performance reduced that unfunded liability to $69m in FY00. However investment performance in YTD FY01 has been less than ½ of that excellent performance in FY00. It is expected that the forthcoming actuarial report will show an increase in the unfunded dollar amount.

A point of possible concern is that after an unprecedented 9 year boom in the equity market when many pension plans became flush and actually overfunded, allowing the sponsors to reduce annual cash contributions, the City still has an unfunded liability. This, taken together with the growing annual liability (as a percent of payroll base) for the "retroactive" pension improvements is a cause for concern.

The City has an actuarial driven plan that has the City's annual cash contribution (i.e. budget expense) to the Pension Trust increasing a half percentage point of total payroll base each year until the actuarial formula is in balance. This half point step increase each year could go on for years, how many years depending on actual pension fund results versus actuarial assumptions. Apparently if future benefit improvements are granted, even if for past service, the increase in the current budget expense will still be the same half point per year – the annual increases will just continue for much longer.

The following example illustrates the magnitude of this situation:

> FY01 expense = $66.0m
> If payroll dollars increase 6% per year, (due to inflation plus staff growth) and the .5% increase in pension expense rate continues for at least five years, then FY06 expense would be $104.2m, a 58% or $38m increase.

The resulting question from the foregoing is whether this increasing cost element (which is "non-discretionary" since the pension commitment has already been made) is well comprehended in out year budget strategies.

Of possible greater concern is the "unfunded" retiree medical liability. Retiree medical benefits are, as of a 1996 citizen vote, effectively being paid out of the Pension Trust Fund on a cash incurred basis (as distinct from the expense being accrued and cash flow funded when the benefits are earned). FY00 incurred an expense of $5.4m. FY01 was $7.2m (a 33% increase). While this expense line item is much smaller than the Pension expense, it might be a "false comfort" and therefore misleading. Nowhere is the amount of the total unfunded retiree medical liability visibly acknowledged nor, I believe, even understood. The actual budgeted expenditure for this binding obligation appears to be "buried" as part of the actuarial computation to develop the annual pension cash contribution.

There is a growing workforce, a very early age for retirement (50 for "Safety" employees and 55 for "General" employees), a lengthening of life spans, and an ever increasing cost of health care. As a consequence, retiree medical costs represent a "non-discretionary" expense which, as an almost certainty, will grow faster, and most probably much faster, than the current employee salary base in the City budget.

While this retiree medical piece is a relatively small budget item, this line item will most likely consume an increasing amount of City funds in the future, in essence for costs of <u>prior</u> years' employee service. It is conceivable this liability at today's present value could exceed $100m. It is unclear how well the City policy makers appreciate this potential and the fact that either i) other expenses will need be cut to satisfy these continually growing, mandatory health care costs, or ii) additional revenues will need be raised.

At a minimum the City should ask for a comprehensive analysis, based on today's known actuarial facts, to determine for how many years in the future will the pension contribution expense have to increase by a half percentage point of the total payroll base. Additionally the City should be apprised of the current present value of the unfunded retiree medical liability and a simulation model should be run to determine how soon the City will have to add a separate budget line to pay retiree medical costs out of annual cash flow rather than out of Pension Trust Fund earnings as at present.

NOTE: Special thank you to Terri Webster and Larry Grissom, City Pension Manager, for answering my questions.

6/30/01
($ in millions)

	FY01 / Est	FY00	FY99	FY98	FY97	FY96
Pension Fund Assets	$2.801	$2.999	$2.476	$2.272	$1.855	$1.604
City Budget Cash Contribution	$66	$61	$56	$51	$48	$44
Pension Plan Cash Benefits Paid	$150	$111	$98	$83	$66	$61
Unfunded Actuarial Liability	N/A	$69	$148	$125	$117	$140
Retiree Medical Benefits paid out	$7.2	$5.4	$5.4	$4.4	$5.0	$5.0

N/A = Not yet available

binding obligation appears to be an "indirect" part of the actuarial computation to develop the annual pension cash contribution. The City's practice is in accordance with current Generally Accepted Government Accounting Principles (GAAP). However, 12 years ago GAAP was changed for private industry to require the recognition annually of the cost of future retiree health benefits being "earned" that year by the current work force. The reason for this accounting change was the growing concern over the very sizeable liabilities for future payments that were not being fully recognized.

The Committee recognizes the City has the potential for this same problem, i.e. a sizeable, growing liability for future payments. The City has a growing workforce, an early age for retirement (50 for Public Safety employees and 55 for General employees), a lengthening of life spans, and an ever increasing cost of health care. As a consequence, retiree medical costs represent a "non-discretionary" expense, which will grow faster and most probably much faster, than the current employee salary base in the City budget.

While this retiree medical cost is currently a relatively small budget item, it will most likely grow at an increasing rate, in essence for costs of prior years' employee service. It is conceivable this liability at today's present value could exceed $100 million. It is unclear how well the City policy makers appreciate this overall expense issue and how it will affect the City budget in the future.

C. FUNDING LEVEL

SDCERS is not in a fully funded position. It is currently funded at 97% (i.e. its current assets equaled 97% of the actuarially computed present value of the future Pension Plan liabilities). The absolute dollar amount of under funding hit a peak of $148 million in Fiscal Year 1999. Excellent Pension asset investment performance reduced that unfunded liability to $69 million in Fiscal Year 2000. However, investment performance in Fiscal Year 2001 was less than half of the excellent performance in Fiscal Year 2000. Investment performance in the first seven months of Fiscal Year 2002 is lower than in Fiscal Year 2001. It is expected that the forthcoming actuarial report will show an increase in the unfunded dollar amount.

San Diego City Employees' Retirement System Financial Information
For Fiscal Years 1996 – 2001
($ IN MILLIONS)

	2001	2000	1999	1998	1997	1996
Pension Fund Assets	$2,807	$2,999	$2,476	$2,272	$1,855	$1,604
City Pension Expense	$68	$61	$56	$51	$48	$44
Pension Plan & Health Benefits Paid	$155[1]	$112	$100	$85	$67	$62
Unfunded Actuarial Accrued Liability	Not available	$69	$148	$125	$117	$140
Retiree Health Benefits Expense	$7	$5	$5	$4	$5	$5

[1] includes $24 million Corbett pay out settlement.

EXHIBIT # 28

2/27 Rules 9am 12th flr

CONFIDENTIAL
DRAFT
1/24/02

CITY OF SAN DIEGO
BLUE RIBBON COMMITTEE ON FINANCES
TABLE OF CONTENTS

Executive Summary **Page No.**

Background 2

Objectives 3

Findings and Recommendations 4

Conclusion 9

Summary of Recommendations 11

Major Fiscal Areas

I. General Reserves and Insurance.....12

II. Long Term Debt 14

III. Retirement Benefits and Unfunded Pension Liabilities 19

IV. General Deferred Maintenance and Unfunded Procurement 23

V. Water, Wastewater, Storm Water and Multiple Species Conservation Program 27

VI. Revenues and Expenditures 35

VII. Principles of Budgeting and Finance 38

Attachments

1. City of San Diego Achievements
2. Moody's California Cities Ratings
3. Moody's The Nation's Cities Ratings
4. Long Term Debt Analysis
5. Debt Service Analysis
6. General Fund Revenue Per Capita
7. General Fund Expenditures Per Capita

EXHIBIT # 29

industry to require the recognition annually of the cost of future retiree health benefits being "earned" that year by the current work force. The reason for this accounting change was the growing concern over the very sizeable liabilities for future payments that were not being fully recognized.

The Committee recognizes the City has the potential for this same problem, i.e. a sizeable, growing liability for future payments. The City has a growing workforce, an early age for retirement (50 for Public Safety employees and 55 for General employees), a lengthening of life spans, and an ever increasing cost of health care. As a consequence, retiree medical costs represent a "non-discretionary" expense, which will grow faster and most probably much faster, than the current employee salary base in the City budget.

While this retiree medical cost is currently a relatively small budget item, it will most likely grow at an increasing rate, in essence for costs of prior years' employee service. It is conceivable this liability at today's present value could exceed $100 million. It is unclear how well the City policy makers appreciate this overall expense issue and how it will affect the City budget in the future.

C. FUNDING LEVEL

SDCERS is not in a fully funded position. It is currently funded at 97% (i.e. its current assets equaled 97% of the actuarially computed present value of the future Pension Plan liabilities). The absolute dollar amount of under funding hit a peak of $148 million in Fiscal Year 1999. Excellent Pension asset investment performance reduced that unfunded liability to $69 million in Fiscal Year 2000. However, investment performance in Fiscal Year 2001 was less than half of the excellent performance in Fiscal Year 2000. Investment performance in the first five months of Fiscal Year 2002 is lower than in Fiscal Year 2001. It is expected that the forthcoming actuarial report will show an increase in the unfunded dollar amount.

San Diego City Employees' Retirement System Financial Information
For Fiscal Years 1996 – 2001
($ IN MILLIONS)

	2001	2000	1999	1998	1997	1996
Pension Fund Assets	$2,807	$2,999	$2,476	$2,272	$1,855	$1,604
City Pension Expense	$68	$61	$56	$51	$48	$44
Pension Plan & Health Insurance Benefits Paid	$155[1]	$112	$100	$85	$67	$62
Unfunded Actuarial Accrued Liability	Not available	$69	$148	$125	$117	$140
Retiree Health Insurance Expense	$7	$5	$5	$4	$5	$5

[1] includes $24 million Corbett pay out settlement.

Conclusions

1. The City is not paying out of its current year's budget the full cost being incurred by its current workforce for their future pension and retiree health benefits. As a result, a portion of the cost of today's City workforce will be paid by future year's taxpayers. As compared to an alternative,

CONFIDENTIAL DRAFT

2/14/02

BLUE RIBBON COMMITTEE REPORT ON CITY OF SAN DIEGO FINANCES
TABLE OF CONTENTS

Executive Summary — **Page No.**

Background 2

Objectives 3

Findings and Recommendations 5

Conclusion 10

Summary of Recommendations 12

Major Fiscal Areas

I. General Reserves and Insurance 13

II. Long Term Debt 15

III. Retirement Benefits and Unfunded Pension Liabilities 20

IV. General Deferred Maintenance and Unfunded Procurement 24

V. Water, Wastewater, Storm Water and Multiple Species Conservation Program 28

VI. Revenues and Expenditures 36

VII. Principles of Budgeting and Finance 38

Attachments

1. City of San Diego Achievements
2. Moody's California Cities Ratings
3. Moody's The Nation's Cities Ratings
4. Long Term Debt Analysis
5. Debt Service Analysis
6. General Fund Revenue Per Capita
7. General Fund Expenditures Per Capita

EXHIBIT # 30

funding obligation appears to be an "indirect" part of the actuarial computation to develop the annual pension cash contribution. The City's practice is in accordance with current Generally Accepted Government Accounting Principles (GAAP). However, 12 years ago GAAP was changed for private industry to require the recognition annually of the cost of future retiree health benefits being "earned" that year by the current work force. The reason for this accounting change was the growing concern over the very sizeable liabilities for future payments that were not being fully recognized.

The Committee recognizes the City has the potential for this same problem, i.e. a sizeable, growing liability for future payments. The City has a growing workforce, an early age for retirement (50 for Public Safety employees and 55 for General employees), a lengthening of life spans, and an ever increasing cost of health care. As a consequence, retiree medical costs represent a "non-discretionary" expense, which will grow faster and most probably much faster, than the current employee salary base in the City budget.

While this retiree medical cost is currently a relatively small budget item, it will most likely grow at an increasing rate, in essence for costs of prior years' employee service. It is conceivable this liability at today's present value could exceed $100 million. It is unclear how well the City policy makers appreciate this overall expense issue and how it will affect the City budget in the future.

C. FUNDING LEVEL

SDCERS is not in a fully funded position. It is currently funded at 97% (i.e. its current assets equaled 97% of the actuarially computed present value of the future Pension Plan liabilities). The absolute dollar amount of under funding hit a peak of $148 million in Fiscal Year 1999. Excellent Pension asset investment performance reduced that unfunded liability to $69 million in Fiscal Year 2000. However, investment performance in Fiscal Year 2001 was less than half of the excellent performance in Fiscal Year 2000. Investment performance in the first seven months of Fiscal Year 2002 is lower than in Fiscal Year 2001. It is expected that the forthcoming actuarial report will show an increase in the unfunded dollar amount.

San Diego City Employees' Retirement System Financial Information
For Fiscal Years 1996 – 2001
($ IN MILLIONS)

	2001	2000	1999	1998	1997	1996
Pension Fund Assets	$2,807	$2,999	$2,476	$2,272	$1,855	$1,604
City Pension Expense	$68	$61	$56	$51	$48	$44
Pension Plan & Health Benefits Paid	$155[1]	$112	$100	$85	$67	$62
Unfunded Actuarial Accrued Liability	Not available	$69	$148	$125	$117	$140
Retiree Health Benefits Expense	$7	$5	$5	$4	$5	$5

[1] includes $24 million Corbett pay out settlement.

Office of
The City Attorney
City of San Diego

MEMORANDUM

DATE: February 8, 2005

TO: Michael Aguirre, City Attorney

FROM: Sam Alatorre, Word Processing Operator

SUBJECT: City Council Rules Committee Discussion of 27 February 2002 re: Report from the Mayor's Blue Ribbon Committee on Budget and Finance: Partial Transcript

---

VORTMANN: Good morning, I'm Dick VORTMANN and I'll be addressing the third key area that the committee investigated, and that's the retirement benefits and unfunded pension liabilities; and that includes both pension as well as retiree medical benefits. The basic conclusion that the committee reached is that the City is not paying from its current year budget the full cost incurred by its current year work force for their ultimate future pension and retiree health benefits. As a result of that, part of today's cost will be paid by future year tax payers; and that's a concern. Further, this nondiscretionary pension expense as a budget item has been steadily growing and will continue to grow in the future.

This next chart shows the pension expense as expressed as a percentage of the City's payroll base. And you can see that as a percentage it has been steadily increasing, clearly the pension expense has been increasing faster than the underlying payroll base. The budget line itself has been growing for the last five years at a 9 percent per year compounded rate. And that is a very troublesome trend for any business to see. And particularly when it is, as I said, as a non-discretionary item and in the '01 budget it was already at 68 million dollars, one of the larger line items.

Further, this expense expressed as a percentage of payroll is scheduled to continue to increase by a half percentage point per year. For example, by calculation by the time you get to FY 06, the current 68 million expense would be 106 million. The committee came up with two recommendations. First recommendation is to change the City's funding strategy to one that results in the City fully funding its future obligations that are being earned today and that would include both the pension benefits as well as the health benefits. Obviously, this would increase the expense for the current years, but will stop pushing the burden out to future years tax payers.

The second recommendation is to make sure that all on the City Council fully understand the mechanics, which are complicated, but the mechanics of the cost of pensions and retiree medical benefits. To ensure that we recommend that you obtain a current and comprehensive analysis of

EXHIBIT # 31

the projected pension expenses and the revenue sources, which includes the current present value of retiree health benefits to determine the impact on future City finances. We believe this is particularly important to get this analysis and understanding before any further pension improvements are considered.

MAYOR: Ok, let's stop on item 3, Retirement Benefits and go to Byron.

WEAR: Can you quantify, if you can go back to the other slide there, if we were to have a strategy to keep it at the. . . you know, reduce the bleeding and keep it at 14.1, just hold the line here, we are still going to have a problem in later years, is that correct then?

VORTMANN: I do not believe you can hold it at 14.1.

WEAR: How do you translate it into dollars, how much more money, because would we have to put in to cover those costs.

VORTMANN: I believe, Ed, you have the number of, the annual short fall right now.

RYAN: Yeah, I believe that the net pension obligation runs somewhere around 6 to 8 million dollars a year, we are under funding.

WEAR: By how much?

RYAN: About 6 to 8 million a year.

VORTMANN: By 6 to 8 million a year, that you're under funding.

WEAR: That includes both general fund departments and enterprise fund departments. So, of the general fund that'll be progressed about 35, 40 percent of that.

RYAN: Oh, probably 60, 70.

WEAR: Towards the general fund?

RYAN: Yeah.

WEAR: So that's something that we need to look at as part of our budget deliberation.

RYAN: Yes.

WEAR: Ok, so for 6 or 8 million we can keep it at 14.1?

RYAN: Um, I don't know the answer to that, what the 6 to 8 million dollar does, is assure that you fund your current pension obligations, whether it changes the percentage or not, my guess, at the moment is that it will not stop the percentage from increasing because of the way the City agreed to fund the benefit given. It's under funding even the normal obligation because it intentionally back loaded the funding.

WEAR: Ok, I think this probably needs a whole hour unto itself and we need to get in the nitty gritty of what this is.

RYAN: Yes.

WEAR: It sounds like our own little version of the Social Security scandal here.

RYAN: It's not a scandal at all. The City intentionally entered into an agreement with the retirement fund to give a benefit about 5 or 6 or 7 years ago and came up with a non-standard way of funding it that the Retirement Board and the actuary accepted.

WEAR: What you are saying, it's going to have a general fund hit in later years.

RYAN : It was intentionally back loaded.

WEAR: Back loaded?

RYAN: Yes.

WEAR: Ok, well, sounds like someone is going to pick up the tab later. We are just affirming the ultimate . . .

VORTMANN: That's what the committee is telling you. And is also telling you that, when you went into it, you expected not to have enough pension obligation, but you are in fact having one because expectations didn't quite meet with the plan.

WEAR: Well, ok but we need to get into this at a later time.

MAYOR: I think Mr. Wear is right, this almost merits a whole discussion, you know, its kind of one of those things that the Retirement Board is in charge of, but we sort of put our head in the sand, but there is really, as I understand there's two issues here, separate. One issue is that we are not currently providing funding to make the pension fund whole, I guess for the lack of a better term. In other words, we should be putting 6 or 8 million dollars in a year or more to make it actuarially sound. And then, in addition to that, in addition to the under funding, we have this issue, that because of the way our system is structured, we are going continue to be increasing the percentage of our, as a percentage of our payroll base, going towards retirement. And even if we fully funded it, this would still be going up because there are more people drawing on the retirement system.

ANONYMOUS: [LEFT BLANK]

MAYOR: Ok, and the last question I have is, to what extent does the investments of the retirement fund offset the under funding? In other words, if the retirement fund, you know bought Qualcomm stocks two years ago and it went up 8,000 percent, does that solve the problem?

VORTMANN: [left blank]

MADAFFER: When I read this, Fred, before we started the meeting, I was extremely troubled to read that we are not paying the 6 to 8 million dollars for future pension. You know, here we are getting to go into the meet and confer process, you know we are in a tight budget year, I think all four unions are expecting pay increases for the employees. Healthcare is out of control around the country, and certainly in San Diego, anywhere from 20 to 50 percent and then we have this on top of it. And then of course you read the rest of the things, especially on the recommendations 4, 5, and 6 and we are in deep trouble here as a City, by virtue of the fact that we have done so very well from a fiscal health stand point but I read your definition of fiscal health and it is to maintain existing service levels when local and regional economic disruptions goes on and on and on. And that's a good definition, but I don't know if maintaining is what the public or the employees are going to be happy with. Certainly the public is not happy with it, we've done a lousy job fixing potholes, repairing sidewalks and everything else. I don't know about, if we can deal with the maintain thing. You know its one thing that we are going to get taken more money by the state probably next year and all the other problems we got. Now we add another 8 million dollars a year that we need to add in and that's growing. I'm just extremely troubled by that and I hope Mr. Manager when you come back with the budget that you present to the Council in May, that you address this issue and come up with a plan. This is definitely a huge hit.

MAYOR: I expecting the City Manager to come back hopefully at our next meeting which is in three weeks with the response on every one of these issues. . . . . Anyway, this is exactly why this Blue Ribbon Committee is turned out to be a very helpful group because they say, look on your bonds you are doing great but on your pension plan you're not. And that's the kind of objective look we need.

[side B]

UNIDENTIFIED FEMALE: [left blank]

MAYOR: The plan would be that the full Council would do a workshop on the Blue Ribbon Committee's report in April. By then, the City Manager would hopefully have a response on some of these things. But to the extent that we take any one of these pieces and go into a greater depth like the pension issue, I think that would be something that this committee would look at along with the pension board. And maybe a representative group and committee just to focus on that issue. I don't see us addressing that in depth prior to the May budget. I see us only dealing it at this level, which is. . . superficial wouldn't, not mean to be an unkind word but, this requires a greater depth of understanding in our part before we took any action, I guess, and I don't see us being able to do that between now and the May budget process.

I think that concludes the questions on part 3.

:sa

Mail

Close

Previous Next

From: Terri Webster
To: Grissom, Lawrence
CC:
Date: 3/7/2002 5:56 PM
Subject: Re: Blue Ribbon Report

please call and I left you a voice mail

>>> Lawrence Grissom 03/07/02 04:58PM >>>
Hi Terri
Just got a call from Ray Huard at the Tribune wanting comment on the report's statement that the City is seriously funding its retirement plan. I told him that I had not had the opportunity to read the report and would like to before I made any comment.

Thnik I'll tell him that we are seriously underfunded due to the City not paying it's fair share.....OK with you???

Seriously, is there any "party line" for me to communicate?
Larry

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

EXHIBIT # 32

From: Lawrence Grissom
To: Dvortman@nassco.com
Date: Wed, Mar 13, 2002 5:16 PM
Subject: Response to your questions

Dick
Quick e-mail in response to your questions of March 13.

Under the manager's proposal, if the funding ratio drops to or below 82.3%, the City will be required to escalate the employer contribution from whatever the current level is to the acutarially recommended rate. No retro payment of undercontributions would be required. Using the current scenario as an example, the City is scheduled to go to 10.33% on July 1, 2002. If the current funding ratio were at or below 82.3%, they would go to the actuarial rate of 15.59%. This would represent an additional dollar contribution of approximately $25.2 million, which is more than Cathy's estimate of $20 million. this would have no impact on the moneys available to pay retiree health under the current scenario.

Yes, staff has discussed this situation at length with City management. Currently, there is some discussion of the issue almost daily.

Larry

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

CC: Fred Pierce

EXHIBIT # 33

THE COMMITTEE ON
RULES, FINANCE AND INTERGOVERNMENTA L RELATIONS
OF THE CITY COUNCIL OF THE CITY OF SAN DIEGO
(MAYOR DICK MURPHY, CHAIRPERSON)

Action Items for meeting of Wednesday, February 27, 2002

ITEM-1: Discussion re: Report from the Mayor's Blue Ribbon Committee on Budget and Finance.

The Committee voted 4-0 to accept the report and to direct the City Manager to prepare a response and to return to the Rules Committee on March 20, 2002. (Motion: Madaffer; Second: Atkins; Not Present: Stevens)

ITEM-2: Discussion re: San Diego's Proposed Urban Forest.

The Committee voted 4-0 to accept the Tree Advisory Board's "Community Roots" report and to refer all recommendations contained therein to the City Manager to prepare a response and to return to the Rules Committee on April 10, 2002. (Note: The Tree Advisory Board was invited to return on April 10, 2002, to present their funding recommendations.) (Motion: Wear; Second: Atkins; Not Present: Stevens)

ITEM-3: Discussion re: Proposal to amend Municipal Code Section 35.0111 to reflect an increase in the room rental charge amount exempt from Transient Occupancy Tax (TOT) from $20 per night to $25 per night.

The Committee voted 4-0 to approve the City Manager's recommendation contained in City Manager's Report 02-041. (Motion: Wear; Second: Atkins; Not Present: Stevens)

EXHIBIT # 34

THE CITY OF SAN DIEGO

MANAGER'S REPORT

DATE ISSUED: March 18, 2002 REPORT NO. 02-061

ATTENTION: The Committee on Rules, Finance and Intergovernmental Relations Agenda of March 20, 2002

SUBJECT: Response to the Blue Ribbon Committee Report

REFERENCE: Blue Ribbon Committee Report on City of San Diego Finances - February 2002

SUMMARY

Issue: Should the City of San Diego implement the Blue Ribbon Committee's recommendations for the City's continued fiscal health?

Manager's Recommendations: Analyze the Blue Ribbon Committee's recommendations and return to the City Council with proposed implementation strategies.

Other Recommendations: None

Fiscal Impact: Several of the Blue Ribbon Committee's recommendations will require additional funding that will need to be identified in conjunction with the development of solutions to the issues raised by the Committee.

BACKGROUND

In April 2001, the Mayor convened the Blue Ribbon Committee on City Finances to perform an independent evaluation on the City's current fiscal health and make appropriate recommendations. The objectives of the Committee were to perform an independent evaluation of the fiscal health of the City of San Diego, review the budgeting principles of the City of San Diego, and report findings and recommendations to Mayor Dick Murphy.

Overall, the Committee found that the City is fiscally sound. However, it identified several areas of concern which could potentially have an impact on the fiscal health of the City in future years. The areas of concern included General Reserves and Insurance, Retirement Benefits and

EXHIBIT # 35

Unfunded Pension Liabilities, General Deferred Maintenance and Unfunded Procurement, Revenues and Expenditures, and Principles of Budgeting and Finance.

The City Manager agrees with the Committee's recommendations and consistent with the Blue Ribbon Committee's suggestion, will return with a progress report to the Rules Committee in March 2003. Prioritization of each recommendation will be based on the impact to the General Fund, availability of resources, time for completion, and the opportunity to improve the City's fiscal health.

DISCUSSION

The Blue Ribbon Committee Report made ten recommendations to improve the fiscal health of the City of San Diego. The Blue Ribbon Committee Report is attached. This City Manager's Report is in response to the Blue Ribbon Committee Report and lists each Blue Ribbon Committee recommendation and the methods the City Manager proposes to implement these recommendations.

General Reserves and Insurance

Blue Ribbon Recommendation #1: Evaluate and determine what an adequate reserve level is for the City. The Committee recommends increasing the reserves to be between 7-10% of General Fund Revenues.

It is understood that San Diego must have sufficient funds in reserve that are available in a time of fiscal crisis to cover unplanned short-term economic downturns or address emergency situations. The City's General Reserves have more than doubled since 1997 and are currently $30.5 million (approximately 4% of the Fiscal Year 2002 General Fund revenues). The City Manager will evaluate the current reserves and develop recommendations. The City Manager agrees that total General Reserves should be monitored to ensure that a sufficient reserve is maintained.

Retirement Benefits and Unfunded Pension Liabilities

Blue Ribbon Recommendation #2: Change the City's Funding strategy to one that results in the City fully funding its future obligations earned today which includes the pension benefits as well as health benefits.

Blue Ribbon Recommendation #3: Obtain a current and comprehensive analysis of projected pension expenses and revenue sources, which includes the current present value of retiree health benefits to determine the impact on future City finances.

The City Manager agrees that unfunded retiree health benefits will continue to be a liability against future revenues. The City Manager will ask the City Retirement Officer to assist the City in obtaining a comprehensive analysis of the Blue Ribbon Committee's recommendations. Upon completion of the analysis, the City Retirement Officer and the City Manager will present to the Mayor and City Council the results of the analysis and recommendations where appropriate.

General Deferred Maintenance and Unfunded Procurement

Blue Ribbon Recommendation #4: The City Manager should establish a process so that all deferred maintenance and unfunded procurement information is developed, aggregated, consistent, complete, non-duplicative, rated for priority, and is available on call for budgetary decisions.

Blue Ribbon Recommendation #5: The City Manager should prepare and present a public report during the annual budget hearings identifying the cumulative deferred maintenance backlog and unfunded procurement needs which includes asset descriptions, dollar requirements, and categorized by level of need with funding sources.

The City Manager concurs that physical assets require periodic major maintenance and that a comprehensive inventory would assist in prioritizing projects. In order to assess the magnitude of maintaining and/or replacing major capital items, the City Manager will explore opportunities to develop a consistent and non-duplicative ongoing assessment of all City assets so that information will be available annually during budget hearings. Although these efforts will be initiated at this time, the development of a comprehensive list may not be available in time for the Fiscal Year 2003 budget hearings.

During the past year, the General Services Department has addressed two important aspects of the issues raised by the Committee. First, the City's non-public safety fleet was evaluated relative to size and condition. As a result, the fleet was downsized by approximately 150 vehicles thus saving $1 million annually, and the acquisition program was restructured utilizing lease-purchases to insure timely replacement of fleet vehicles. This restructuring resulted in a one-time savings of $2 million, which will be returned to the General Fund in Fiscal Year 2003.

Secondly, an assessment of the City's buildings was undertaken approximately eight months ago. This assessment will update the 1990 study evaluating the condition of the City facilities and placing a value on the deferred maintenance of those facilities. In addition to the update of the earlier report it will provide a guide in developing a consistent and accurate ongoing assessment of all City facilities.

Blue Ribbon Recommendation #6: The City's policy with respect to funding deferred maintenance and Information Technology procurement should be revised to increase expenditures in these crucial areas. While the Committee notes some improvement in addressing deferred maintenance needs in some specific areas, other areas continue to deteriorate.

The Committee believes that the City's backlog of general deferred maintenance exceeds $300 million. In addition, the City estimates $120 - $170 million in Information Technology needs over the next five years. The City Manager will make funding recommendations in the annual budget process based upon the deferred maintenance assessments, unfunded procurement priorities, availability of revenues and overall budget priorities.

Revenues and Expenditures

Blue Ribbon Recommendation #7: Expand the current revenue sources and seek additional sources of revenue.

In comparison to other large cities in California and the nation, the City has a relatively low revenue base. Despite efforts during recent years to incorporate new General Fund revenue

options into the City's budget, such as the Corporate Sponsorship Program, which was instituted in Fiscal Year 2000, San Diego has assessed few new fees and has adopted no additional tax increases to existing General Fund revenues. The only significant new fees or revenue increases were the implementation of the Refuse Collector Business License Tax, and the increase in the Transient Occupancy Tax rate from 9 percent to 10.5 percent, which were adopted during the 1990s. In addition, the City has actually reduced some fees in an effort to become more business-friendly.

The City of San Diego does not collect revenue for refuse collection and utility user taxes. In addition to the City's low revenue base, for fiscal years 1991-2002 the State of California diverted approximately $283 million of revenue away from the City of San Diego. This diversion has lowered the City's revenue base thus contributing to the deferred maintenance issue. In 1990, two of the major General Fund revenue sources, Property Tax and Sales Tax, were sufficient to fund the entire public safety budget; however, today these revenue sources cover only 80 percent of public safety allocations. Additional revenue could help fund general City operations, public safety, deferred maintenance, information and technology, and the Strategic Framework Element of the General Plan Update including the City of Villages concept.

In light of the current recession, the City of San Diego may want to consider revenue-generating options, which may include new assessments such as a Refuse Collection Fee and Utility User Tax and increases to existing revenue sources such as the Storm Drain Fee, Property Transfer Tax, Transient Occupancy Tax, and Sales Tax. The City Manager will work with the Mayor, City Council and key stakeholders to explore options for expanding the City's revenue base.

Blue Ribbon Recommendation #8: Seek ways to reduce expenditures through improved operational efficiencies or elimination of specific services in deference to higher priority needs.

The City has reduced expenditures and improved operational efficiencies by implementing its Performance Management Program and establishing the Select Committee on Government Efficiency & Fiscal Reform (Select Committee). The key elements of the Performance Management Program include Performance-Based Budgeting, the Optimization Program, Zero-Based Management Reviews (ZBMR), Performance Audits and benchmarking. Since 1994, the ZBMR and Optimization Program have served to stimulate numerous process improvements, cost reduction initiatives, and has saved the City over $100 million. The Select Committee also charged with initiating change efforts and finding innovative solutions for streamlining and downsizing city government, has been effective in implementing recommendations from the Mayor's Task Force, the City Council, and other committees.
In addition, the City Manager for fiscal years 2002 and 2003 requested that General Fund departments take a critical look at their operations and achieve at least a 2% expenditure savings. The City Manager will continue to review expenditures and pursue opportunities to improve operational efficiencies with the support of the above ongoing programs. Additionally, all City of San Diego services will be reviewed by the City Manager to identify funding priorities in light of limited revenue sources.

Principles of Budgeting and Finance

Blue Ribbon Recommendation #9: The City should follow its existing six budget principles and add two additional budget principles:

Proposed Principle #7: Budget development should be guided by a long term, or

strategic budget plan proposed by the Manager and adopted by the Council.

Proposed Principle #8: Once adopted, annual budgets should be amended only when urgency requires, and then by identifying specific funding sources for these new priorities.

The City Manager will add these principles and incorporate them into future budget development and administration.

Follow-up Issues

Blue Ribbon Recommendation #10: Submit a report in March of 2003 addressed to the Blue Ribbon Committee on Finances summarizing the progress on each recommendation contained in [the] report.

Consistent with the Blue Ribbon Committee's recommendation, a comprehensive report will be presented to the Rules Committee in March 2003, which will provide the status of the implementation of the Blue Ribbon Committee's recommendations.

CONCLUSION

I would like to take this opportunity to thank the members of the Blue Ribbon Committee for their objective analysis and recommendations to ensure the City's continued fiscal strength. I agree in general with the recommendations and anticipate working with the Mayor, City Council and key stakeholders in consideration of implementing the recommendations as provided by the Blue Ribbon Committee.

Respectfully submitted,

_____

Michael T. Uberuaga
City Manager

IRVINE/CMC

Note: The attachment is not available in electronic format. Copies of the attachment are available for review in the Office of the City Clerk.

Attachment A – Blue Ribbon Committee Report on City of San Diego Finances – February 2002

Office of
The City Attorney
City of San Diego

MEMORANDUM

DATE: February 8, 2005

TO: Michael J. Aguirre, City Attorney

FROM: Sam Alatorre, Word Processing Operator:

SUBJECT: City Council Rules Committee Discussion of 20 March 2002 re: City Manager's response to the recommendations made by the Mayor's Blue Ribbon Committee on Budget and Finance: Partial Transcript

---

MAYOR: The uh, on my memo recommendation number two says that we refer the issue initially to the Retirement Board and ask them to give us a report by June 30th and so I guess there is an issue here of how best to do this, my concern is that, I wasn't so sure that it was appropriate for this committee to go off on its own. The Retirement Board has the legal responsibility under the Charter to oversee the operation of the retirement system and so my recollection is that we only indirectly control what they do. So, to come directly here with a workshop at least seem to violate protocol, if not, losing the lack of the Retirement Board thoughts and input on this.

Thin what I now discovered based on really the Blue Ribbon Committee, I mean, what the Blue Ribbon Committee really pointed out on this issue was something that a lot of this Council wasn't even aware of. And it turns out, maybe, I think this is a fair statement, that there was, perhaps some decisions made by prior City Councils that deliberately under funded the pension system, in order to cover their budget deficits in the 90s, I mean I don't think it is like a crisis situation but it is a serious situation and we need to address it. But, so I thought we really ought to ask the Retirement Board to respond first. And then have the City Manager and this Committee or the Council have the workshop. Now, if I'm missing something here, let me ask Mr. Vortmann if he sees any problem, if he thinks. It seems to me it ought to go to the Retirement Board first.

MR. VORTMANN [left blank]

MAYOR: I understand your point is, before we even approve a budget this year, we ought to address this issue. And actually we have in part of . . .our process. But the quote, fixing the problem is not really being addressed and I made this the earliest one on the list, the June 30th date, but the problem is addressing this prior to negotiating salary increases for City employees is a difficult time table, I guess.

EXHIBIT # 36

MR. VORTMANN [left blank]

MAYOR: I think Ma'am City Attorney; we kind of need to know what that inner relationship is. I was here when there was a fight between the City Council and the Retirement Board in the 80s over who's in charge and ultimately the City Attorney's opinion was at least on investment decision the Retirement Board is in charge. And this Council can not dictate investment decisions to the Retirement Board, for example . . . but on policy issues about being fully funded, I'm assuming that this Council then has the . . . not only the right but the obligation to set those, make those kind of policy decisions.

UNIDENTIFIED FEMALE [left blank]

MAYOR: What we have is a situation, which is probably healthy in which the Retirement Board has their own attorney who can disagree with the City Attorney, and has. So, even though I agree with Mr. Vortmann, there is some sense of, there is a need for us to understand that there has been historically an under funding of the retirement system, this year in the meet and confer process we need to be aware of that when we negotiate. Nevertheless, I think we need time to address; it's a complicated issue, we need to let the Retirement Board tell us first what they think.

UNIDENTIFIED MALE [left blank]

MR. WEAR: Yeah, your Honor, having looked at this recently in the last week, and the information I've been give, I'm not as concerned as I was when this recommendation popped out three weeks, or two three weeks ago. Uh, I think we need to spend some time on dealing with it. From a long term stand point, it's not a crisis, it's something that can be handled in June or July, I don't think we have to do it right away. I think the schedule is fine.

MAYOR: Yes, cause, the idea would be we'd have this recommendation in June, and then perhaps we can discuss it in July or perhaps the City Manager still needs more time to analyze what their recommendation is.

MR. WEAR: We are doing it about ten times better that the Social Security situation, so.

MAYOR: Yeah, I'm not sure the Social Security system is a good yard stick to follow...

MR. WEAR: That's why I said ten times...

MAYOR: And you recall that the numbers here on the report show that the funding is some where between, in excess of 90 percent of the needs of the system, but 100 percent would be the ideal way to operate in the so. . .

:sa

NATIONAL STEEL AND SHIPBUILDING COMPANY
A GENERAL DYNAMICS COMPANY

RICHARD H. VORTMANN
PRESIDENT

April 29, 2002

Joseph Craver	Via Fax: 619/299-9955
Mary Ball	Via Fax: 619266-5600
April Boling	Via Fax: 619/667-7655
Dennis Gibson	Via Fax: 619/236-7228
Bill McCurine	Via Fax: 619/231-4755
Andrew Poat	Via Fax: 619/234-2915
Aprilrose Riel	Via e-mail
Victor Vilaplana	Via Fax: 619/615-0310
Ed Ryan	Via Fax: 619/236-6219
Terri Webster	Via Fax: 619/236-6219
Linc Ward	Via Fax: 619/440-7050

Dear Fellow Blue Ribbon Committee Members:

With our committee now in "hibernation" until next Spring, as time has past and events gradually unfold at City Hall, I have been reflecting on our final report. As you might recall my redraft of Chairman Joe's initial draft was relative harsh in its appraisal of the City's fiscal health. After much discussion of whether the "sky was really falling" and did we really want to say all that, we, as a group, with my concurrence, evolved to the final version of our conclusion i.e. "the city is in good fiscal shape, but...".

Interestingly, the several "citizen comments" I have received regarding our report have all been essential the same – "yeah, my balance sheet and credit rating would be good too, if I didn't maintain my house and pay all my expenses."

The committee's unstated concern over the ball park financing and any impact to the city's credit rating in general are now behind us. However certain recent developments since our report deliberation seems to accentuate the "buts" we made in our report.

First the City's EPA waiver on the sewer plant is now in question, which, worst case, would result in an mandatory unplanned multi-billion dollar liability. Even if the waiver is finally granted it likely will come with new restrictions which will reduce the available capacity for population growth (and thereby invalidate our report's conclusion that the City had a viable plan for the future assuming the proposed rate increases were approved).

2798 HARBOR DRIVE • SAN DIEGO, CA 92113 • PO. BOX 85278 • SAN DIEGO, CA 92186-5278
TELEPHONE (619) 544-8600 • FAX (619) 544-3541 • E-MAIL: dvortman@nassco.com

EXHIBIT # 37

Second, the City appears to be equivocating on approving the first (of several planned) user rate increases for the Water Department. Worse, regulators, apparently in frustration of lack of progress on improving water quality, are "threatening" to publicly question the safety of our water supply (which most likely would lead to significant mandatory increased spending in facilities).

Third, the issue of storm water containment appears to be heating up with a potential price tag far higher than the "unbudgeted" $143m we stated in our report.

Fourth, as I continue to learn more about the City's pension system, coupled with the impact of the equity market bubble burst on the pension portfolio, it is clear the City has deferred to future taxpayers far more dollars than our report assumed. Further, there appears a chance the City will grant further pension benefits this year which will either increase the pension budget line item or (more likely) push yet more current costs out to future taxpayers. Unlike deferred maintenance, these are mandatory costs which ultimately must be paid; and these amounts explicitly grow with interest when they are deferred.

I have a growing and daunting concern that we possibly did our City a disservice by not ringing a very loud bell that:

i) the City's fiscal health is not what it appears,

ii) there are serious problems,

iii) their solutions will be painful in terms of reduced services and/or increased taxes and fees, and

iv) a comprehensive multi-year strategic plan to deal with the situation must immediately be developed; difficult decisions must be made now.

I offer these personal thoughts for the Blue Ribbon Committee's consideration. Even if you were all to share my concern on this issue, I am not certain of what to do next. I remain hopeful my fears expressed here will prove unfounded, but I am not optimistic.

Sincerely,

Richard H. Vortmann
President

RHV/lh

S.D. panelist's memo warned of fiscal woes; [1,6,7,2 Edition]

Matthew T. Hall. **The San Diego Union - Tribune.** San Diego, Calif.: Feb 3, 2005. pg. B.1.1.6

Abstract (Document Summary)

[Richard Vortmann], president of National Steel and Shipbuilding Co. and a city retirement board member, sent his memo to mayoral aide Dennis Gibson, then-City Auditor Ed Ryan, then-Assistant City Auditor Terri Webster and eight colleagues on the Blue Ribbon Committee on City Finances. Mayor [Dick Murphy] created the panel in 2001 and named the members.

Knowing Vortmann's concerns in April 2002 might not have changed the way the council voted on the pension system later that year, Murphy said.

Vortmann wrote the pension section of the final report for Murphy's Blue Ribbon Committee on City Finances. Vortmann was traveling yesterday and unavailable for comment.

Full Text (847 words)

Copyright SAN DIEGO UNION TRIBUNE PUBLISHING COMPANY Feb 3, 2005

Two weeks after a volunteer committee briefed the City Council on San Diego's fiscal health in 2002, one member wrote his committee colleagues and a mayoral aide that "we possibly did a disservice by not ringing a very loud bell" about serious financial problems.

Mayor Dick Murphy said yesterday that he didn't learn about the memo at the time and only read the warning this week.

In the April 29, 2002, letter, which was circulated around City Hall yesterday, Richard Vortmann wrote that the city's fiscal health "is not what it appears," and that "it is clear the City has deferred to future taxpayers far more dollars than our report assumed" for the city's pension system.

The three-year-old report said the city was fiscally sound but had looming problems with deferred maintenance and its pension system, among other issues. It is under more scrutiny now because of the city's worsening finances.

The Securities and Exchange Commission has been investigating possible securities fraud for a year after city officials said they hadn't revealed the depth of the pension deficit to potential investors in municipal bonds. The U.S. attorney and the FBI also are investigating possible public corruption.

The city pension system has a nearly $1.4 billion deficit now because of intentional underfunding that the council began in 1996, employee benefit increases and market losses.

In 2002, after Vortmann aired his private concerns, the council voted to continue underfunding the system and to increase benefits.

Vortmann, president of National Steel and Shipbuilding Co. and a city retirement board member, sent his memo to mayoral aide Dennis Gibson, then-City Auditor Ed Ryan, then-Assistant City Auditor Terri Webster and eight colleagues on the Blue Ribbon Committee on City Finances. Mayor Dick Murphy created the panel in 2001 and named the members.

Murphy said yesterday that Gibson never showed him the letter. He said his chief of staff, John Kern, told him Gibson never gave him the letter, either.

"He probably should have showed it to me, but I get hundreds of letters, and particularly those that aren't even

addressed to me I would not normally see," Murphy said.

Gibson did not return a telephone call and declined to comment through the mayor's press secretary.

Knowing Vortmann's concerns in April 2002 might not have changed the way the council voted on the pension system later that year, Murphy said.

"By the spring of '02, the city manager was discussing with us this whole underfunding issue and how to deal with it," Murphy said. "One letter, would that have made a difference? I don't know."

Councilman Brian Maienschein said the vote might have gone differently -- and the city might be in better shape -- if the council had known of Vortmann's concerns.

"It would have been information that would have been relevant in any determination as to a vote on the pension system," Maienschein said. "I think it could have changed the chain of events that followed."

The blue ribbon panel's report was first presented to a council committee in February 2002, two weeks after the city completed a bond offering for the downtown ballpark it was building with the Padres.

City Attorney Michael Aguirre said he is investigating the timing of the report on the city's financial health in light of a sentence in Vortmann's memo that addresses "the committee's unstated concern over the ball park financing."

At a news conference yesterday, Aguirre said a prospectus for the ballpark bonds contained "a specific factual misrepresentation, which was repeated in the blue ribbon committee report" that the pension system's funded ratio was higher than it actually was at that point.

Vortmann wrote the pension section of the final report for Murphy's Blue Ribbon Committee on City Finances. Vortmann was traveling yesterday and unavailable for comment.

The weekly newspaper San Diego CityBeat, which first obtained Vortmann's letter, said he denied any link between the report and any bond financing.

"That certainly is reading a hell of a lot into it," Vortmann was quoted as saying. "First of all, our report had no involvement with any bond financing whatsoever. We were an independent volunteer group giving an opinion to the mayor on the fiscal condition of the city and, not to my knowledge, used as a reference for any bond financing and certainly had no authority to be such."

There was never an indication of a cover-up to move the ballpark bonds forward, said committee members April Boling, an accountant and treasurer for Murphy's mayoral campaigns, and Andrew Poat, the city's government relations director.

They said their report was accurate based on the information they had at the time.

"It pointed out several hot spots, and had the city heeded our warnings and dealt with those hot spots, we would not be in the position we are in today," Boling said. "The biggest problem with the Blue Ribbon Finance Committee report is that it was essentially ignored."

A copy of Richard Vortmann's letter can be found online at SignOnSanDiego , the Union-Tribune's Web site, at www.uniontrib.com.

Matthew Hall: (619) 542-4599; matthew.hall@uniontrib.com

Credit: STAFF WRITER

ARTICLE III

LEGISLATIVE POWER

Section 11: Legislative Power

All legislative powers of the City shall be vested, subject to the terms of this Charter and of the Constitution of the State of California, in the Council, except such legislative powers as are reserved to the people by the Charter and the Constitution of the State.

Section 11.1: Legislative Power — Nondelegable

The same prohibition against delegation of the legislative power which is imposed on the State Legislature by Article XI, Section 11a of the Constitution of the State of California shall apply to the City Council of The City of San Diego, so that its members shall not delegate legislative power or responsibility which they were elected to exercise in the adoption of any ordinance or resolution which raises or spends public monies, including but not limited to the City's annual budget ordinance or any part thereof, and the annual ordinance setting compensation for City employees, or any ordinance or resolution setting public policy.

The City Council shall annually adopt an ordinance establishing salaries for all City employees. The City Council shall adopt this ordinance not later than May 30 of each year after considering all relevant evidence including but not limited to the needs of the citizens of the City of San Diego for municipal services, the ability of the citizens to pay for those services, local economic conditions and other relevant factors as the Council deems appropriate. The City Council shall give priority in the funding of municipal services to the need of the citizens for police protection in considering adoption of this salary ordinance and the annual budget ordinance.

The prohibition imposed by this section against unlawful delegation of the legislative responsibility to set compensation for city employees shall extend to any scheme or formula which seeks to fix the compensation of City of San Diego employees at the level of compensation paid to employees of any other public agency whose governing board is not elected by and not accountable to the people of the City of San Diego. This prohibition shall also extend to any scheme or formula which seeks to fix, establish, or adjust the compensation of City of San Diego employees at the level of the largest cities in California or the State of California.
(Addition voted 06-03-1980; effective 07-16-1980.)
(Amendment voted 11-04-1980; effective 12-31-1980.)

EXHIBIT # 39

(Amendment voted 06-03-1986; effective 09-08-1986.)

Section 11.2: Legislative Power — Memorandum of Understanding

Notwithstanding any provisions of this Charter to the contrary, nothing in the Charter shall be construed to preclude the Council from entering into a multiple year memorandum of understanding with any recognized City employee organization concerning wages, hours and other terms and conditions of employment if, in the prudent exercise of legislative discretion as provided in this Charter, the Council determines it is in the best interests of the City to do so; and further provided that said exercise of legislative discretion is expressed affirmatively by a two-thirds vote of the entire Council. *(Addition voted 06-03-1986; effective 09-08-1986.)*

Section 12: the Council

(a) The Council shall be composed of nine (9) Councilmembers, including the Mayor, and shall be the legislative body of the City, each of the members of which including the Mayor, shall have the right to vote upon all questions before it.

(b) At the municipal primary and general election in 1979, a Mayor shall be chosen by the electors for a term of five (5) years. A Mayor shall thereafter be elected for a term of four (4) years in the manner prescribed by Section 10 of this Charter. The Mayor shall hold office for the term prescribed from and after 10 a.m. the first Monday after the first day of December next succeeding the election and until a successor is elected and qualified.

(c) At the municipal primary and general elections in 1993, the Council members for Districts 1, 3, 5, and 7 shall be chosen by the electors for a term of three (3) years. Council members for Districts 1, 3, 5, and 7 shall thereafter by elected for a term of four (4) years in the manner prescribed by Section 10 of this Charter.

(d) At the municipal primary and general election in 1995, Council members for Districts 2, 4, 6, and 8 shall be chosen by the electors for a term of three (3) years. Council members for Districts 2, 4, 6, and 8 shall thereafter by elected for a term of four (4) years in the manner prescribed by Section 10 of this Charter.

(e) Except as provided in this Section, Council members, shall hold office for the term of four (4) years from and after 10 a.m. the first Monday after the first day of December next succeeding their election and until their successors are elected and qualified.

(f) Notwithstanding any other provision of this Charter and commencing with elections held in 1992, no person shall serve more than two consecutive four-year

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

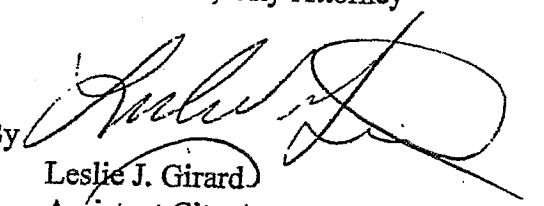
II. Conference with Labor Negotiator, pursuant to Government Code section 54957.6:

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

CITY OF SAN DIEGO
MEMORANDUM

RECEIVED
MAY 24 2002
COUNCIL MEMBER
JIM MATHER

DATE: May 24, 2002

TO: Honorable Mayor & City Council

FROM: Daniel E. Kelley, Labor Relations Manager

SUBJECT: Final Three Year offer to San Diego Police Officers Association

---

Attached are the documents that comprised the City's final three-year offer to the San Diego Police Officers Association (POA), which was rejected by the POA Negotiating Team.

Attachment 1 reflects the City's final offer for a three-year agreement that was presented to the POA on May 9, 2002. Attachment 2 reflects the Cities modified position as a result of the changes authorized by Council as a result of the impasse hearing.

If you would like additional information or detail on specific changes, please call the Labor Relations Office at (619) 236-6313.

Daniel E. Kelley
Labor Relations Manager

Mm

cc: Michael T. Uberuaga, City Manager
Lamont Ewell, Assistant City Manager
Cathy Lexin, Human Resources Director

Attachments

EXHIBIT # 41

CONFIDENTIALITY REQUESTED UNDER LETTER OF MARCH 2, 2004

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
Inzunza
Main
Atkins
Peters
Wear
Mayor
8-0

CLOSED SESSION REPORT [X] CITY OF SAN DIEGO [] OTHER (See below)

TITLE Labor negotiations - meet and confer
labor negotiations HDCA Heap

DATE OF CLOSED SESSION: 3/18, 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: _____

[STAMP HERE]

[] 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 [X] Sr Dep City Mgr (Loveland)
[X] City Atty [X] Exec Asst City Atty [] Asst City Atty (Girard)
[X] City Auditor
[X] Other Bruce Herring, Terri Webster, Pat Frazier, Rich Snapper, Elmer Heap, Sharon Marhsall, Dan Kelley, Bill McGhee, Cathy Lexin, Val Van deweghe

[X] VOTE [] NO VOTE NECESSARY
Economic proposal:

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

COMMENTS: 1) Health Plan: staff recommendation ($10 office, $5 generic/ $10 Brand Rx, $50 ER visit) 8-0-1; 2) Retiree Health: staff recommendation (same as above) 8-0-1; 3) Economic Proposal: staff recommendation: a) POA/Fire/Lifeguards - FY03 1% mid-year + $100 flex each year; 2 yr agree, 2% FY04 mid-year; b) MEA/127 - FY03-1% mid year, + $100 flex, 2 yr agree, 2% FY04 mid-year + willingness to discuss retirement + trigger if we lose VIL fees.

APPROVED: [signature]

NOTE: (D) DISCLOSE FOLLOWING CLOSED SESSION

EXHIBIT # 43

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 reserve funds)
  - Increase in General Member Formula

Union + Ret. Bd

Mone & Madaffer 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

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

approved 6-3 at St. Ly

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

CITY OF SAN DIEGO
MEMORANDUM

DATE: April 26, 2002

TO: Honorable Mayor and City Council

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

SUBJECT: Closed Session Meet and Confer Agenda for April 29, 2002
FOR CONFIDENTIAL USE ONLY

AGENDA

1. **Status of Negotiations** — **INFORMATION**

   A. Police Officers Association
   B. Fire Fighters' Local 145
   C. Municipal Employees Association
   D. AFSCME, Local 127

2. **Management Team Recommendations for Bargaining Authority** — **ACTION**

   A. Miscellaneous Economic Improvements
   B. Retirement Related Issues:
      - Funding Ratio and Impact on City's Contribution Rate
      - 2.5% @ 55 Retirement Formula Funding
      - Retiree Health Insurance Funding
      - "13th Check" Authorization
      - "Corbett" Payment to Retirees

3. **Civil Service Commission Recommendations** — **ACTION**

   Report Back on Specific Special Salary Adjustments
   - Park Ranger Series (Attachment 1)
   - Community Service Officer (Attachment 2)
   - Lifeguards (Attachment 3)

4. **SB 402 - Binding Arbitration** — **INFORMATION**

   Transmittal of CA Court of Appeal 4th District, SB 402 Decision (Attachment 4)

EXHIBIT # 46

From: Cathy Lexin
To: Webster, Terri
Date: 10/11/01 10:13AM
Subject: Re: EEEK

Wow! I've already been asked about the 13th check viability by some retirees...Got your point about the 100M

>>> Terri Webster 10/11/01 9:22:47 AM >>>
FYI
YTD CERS earnings as of August 31, 2001 in the CERS Trust fund is about $15m compared to $53M same time 2000...a 71% drop ! BEFORE 9-11-01 ! It will be tight to even meet the base undistributed earnings distributions for FY 02 (ie. 13th check, corbett, etc) .

I hope meet and confer negotiations result in returning as much of the $100m as possible to employer reserves because the Trust Fund really need to build its equity and halt cost increases to ride through the next few years and keep a fiscally sound funding ratio..... let me know if you have questions.

Terri

EXHIBIT # 47

SAN DIEGO CITY
EMPLOYEES' RETIREMENT SYSTEM
ANNUAL ACTUARIAL VALUATION

June 30, 2002

CITY OF SAN DIEGO

Submitted to

THE RETIREMENT BOARD

San Diego City Employees' Retirement System

San Diego, California

EXHIBIT # 48

Funding Process Indicators - Historic Comparison

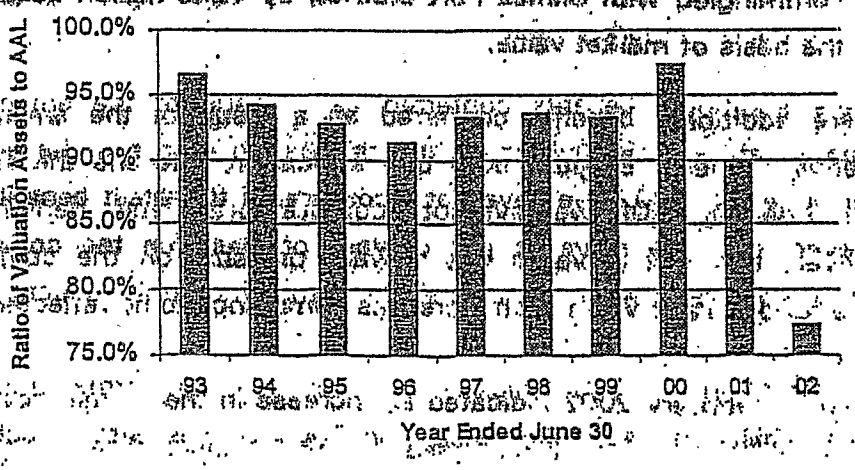
($ in Thousands)

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	$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]	$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%
6/30/02	$2,448,208	$3,168,921	77.3%	$720,713	$535,157	134.7%

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

HOW DID ALL THIS HAPPEN?

MAJOR REASONS FOR THE UNDER-FUNDED PROBLEM
(From July 1, 1996 to June 30, 2003)

1. Investment performance	6%
2. Under-funding by City	10%
3. Use of Plan earnings for contingent benefits	12%
4. Net Actuarial losses	31%
5. Benefit improvements	41%
	100%

Note: This analysis of under-funding does not include future impact of contingent Corbett Settlement and 13th Check.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

EXHIBIT # 49

CLOSED SESSION REPORT [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: 4/29, 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 [ ] Asst City Atty (Girard)
[X] City Auditor
[ ] Other: Jerri Webster, Pat Frazier, Bruce Herring, Stan Hillis, Dan Kelley, Lich 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 Police Admin
Police Dispatchers
Top 3
SSA Mgr's Rec. 9-0
127
POA Harbor Unit (4% increase) 9-0
POA Safety Retirement Status 9-0
Local 145 Heavy Equip Operators 9-0
MEA Dive Team, Helicopter Team Pay, P.E. Sleeping Pay, Lect. Pay, Uniforms - Hues, Police Collect. Supervisor, Uniforms - Park 9-0

APPROVED: Pension
MEA Part 12 = [illegible] 9-0
127 Class A licenses
Survey Mark. Equipment 9-0
Rate [illegible] 9-0
- 8:50 55 (D. Frye-[illegible])
- Retiree Health Trust Funding 9-0
Authority (Pension)

NOTE: (D) DISCLOSE FOLLOWING CLOSED SESSION

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

EXHIBIT # 50

Meet & Confer 2002

Funding the General Member
Retirement Formula Improvement
Modifications to Previous Authority:

Approve General Member retirement benefit enhancement of 2.5% @ 55, with contingencies that Unions support and CERS Board of Administration agrees to:

A. Eliminate *or Reduce* the "trigger" established in the 1997 Manager's Proposal *to 75%*

B. If funding ratio "triggers" an increase in City's contribution rate, *phase in over 5 year period*

C. Absorb Past Liability of the 2.50% at 55 benefit into CERS assets as an unfunded liability (this will reduce funding ratio 1% to 1.5%)

35

Meet & Confer 2002 Agenda

Retirement Issues:

- Funding Ratio Impact on City Contribution (Info)
- 2.5% at 55 General Member Formula (Action)
- *Increases in Employee Pick-ups* (Info)
- Retiree Health Trust Funding Authority (Action)
- Authority to Pay "13th" Check to Retirees (Action)
- Presidential Leave and Retirement Benefits (Action)

36

EXHIBIT # 51

Mail

bse

Previous Next

From: Terri Webster
To: Ryan, Ed
CC:
Date: 1/7/2002, 5:12 PM
Subject: my suggestion on Redraft of pension Sections
Attachments: Redraft of pension Sections

Ed,

I reviewed Dick's changes ...it most places he deleted your recent changes and put back his language....but he did in a small way improve his language. I will suggest some changes to his conclusions to more emphaize the point you made in the meeting Re: % of pension to payroll but after a dozen trys I don't see the value of arguing with him on the wording of the other issues any more and it is too complicated for the rest of the committee to grasp and help change Dick's mind ...so I suggest we agree to disagree...we gave a good shot at changing him ...he just didn't fall for it.. all....

Terri

EXHIBIT # 52

ATTORNEY TO CLIENT
CORRESPONDENCE

FOR CONFIDENTIAL USE ONLY

CITY OF SAN DIEGO
MEMORANDUM

7/16/02
ITEM #3

DATE: June 13, 2002

TO: Honorable Mayor and City Council

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

SUBJECT: Police Officer's Association - Union President

BACKGROUND

During the recently completed labor negotiations, the issue of Union President's retirement benefit was discussed in conjunction with the issue of granting a paid leave of absence for Union Presidents. As you may recall, two of the four Union Presidents, Bill Farrar of POA and Judie Italiano of MEA, have been on leave without pay for two and fourteen years respectively. Both Mr. Farrar and Ms. Italiano have been making contributions to the retirement system based on the salary their respective Unions have been paying them. ~~While the City maintained its position that it never condoned this arrangement, it was clearly acquiesced to by the City Retirement Office. Ron Saathoff, President of Local 145, had requested a similar arrangement approximately one year ago, and that matter became a part of these negotiations as well.~~ As a condition of reaching agreement on successor MOU's, the Council approved the Management Team's recommendation to allow the Union-paid salary (not to exceed the salary of the Labor Relations Manager as a cap) as the basis for retirement benefit calculations.

Since the POA did not reach agreement on a successor MOU, this offer was not extended to Mr. Farrar, the current POA President. Mr. Farrar contacted the Retirement Administrator, Larry Grissom, regarding the processing of his Deferred Retirement Option Plan (DROP) application, and specifically asked whether his Union salary, upon which his retirement contributions have been based, would be used in calculating his retirement/DROP benefit. Mr. Grissom advised Mr. Farrar that based on conversations with City management, Retirement could not use a Union-established salary in calculating his retirement benefit.

EXHIBIT # 53

DISCUSSION

Both Mr. Farrar and his attorney, Dick Castle, have contacted the City Manager's Office asserting that this matter, from their perspective, was never included as part of meet and confer, but rather is a separate and individual issue for Mr. Farrar. Mr. Farrar is aware that the City has agreed to honor the Union paid salary for both MEA and Local 145 Presidents (who have reached agreements on successor MOU's), and will likely assert he is being retaliated against due to the fact POA rejected the City's final offer.

RECOMMENDATION

Given the facts as discussed above, if the City denies Mr. Farrar's request of being treated the same as MEA President and he litigates the issue, there is some legal risk of the City being found liable for retaliation. Therefore, it is recommended that Mr. Farrar be treated the same as the MEA President for purposes of calculating his retirement benefit by having Retirement calculate his benefit based on the higher Union salary. In the alternative, the City could deny Mr. Farrar's contention that he is entitled to a retirement benefit based on his Union salary. In that event, he would be entitled to a refund of the difference between the amount he paid to Retirement based on his Union salary and the amount he should have paid based on his salary if he was paid by the City for his classification.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
MEMORANDUM

DATE: October 29, 2004

TO: Lamont Ewell, City Manager

FROM: Lawrence B. Grissom, Retirement Administrator

SUBJECT: Presidential Retirement Benefits

In October 2002, the City Council passed resolution #297212, regarding the retirement benefits to accrue for City employees who are serving as presidents of their respective unions. The San Diego City Employees' Retirement System has received contributions (on behalf of all of the affected individuals, except the President of Local 145) from their respective unions based upon their salary as Union President. At this time, Ron Saathoff, President of Local 145, has entered the DROP program and we have applications from Judie Italiano, President of MEA; Bill Farrar, President of POA; and Garry Collins, past President of POA, to enter the DROP program.

In light of this situation, coupled with the request of one or more of the above individuals to make the contributions to the DROP program on a tax deferred basis, we felt it prudent to refer the issue of these benefits to our outside tax counsel for review. In summary, they have indicated that SDCERS should not have accepted contributions from any union on behalf of its president, because a union does not meet the tests specified by various Federal agencies as a governmental employer.

Accordingly, tax counsel has advised us that we should refund all such contributions to the respective unions. It is their advice that not to do so, to continue to accept contributions from that source, or to pay benefits based upon contributions thus received, would endanger the tax qualified status of the plan. In this situation, we have no option other than to follow the advice of tax counsel.

My staff and I have met with appropriate members of your staff, Auditor's staff, and the City Attorney to discuss the situation in detail. It is our understanding that it is the intent to establish benefits for the Union Presidents within the spirit of the original resolution. Realizing that this may well take some time to accomplish, we will not initiate the refund of contributions until November 15, 2004, at the earliest. We hope this will give you satisfactory time to determine what course of action you wish to take.

My staff and I stand ready to assist in any way we can.

Lawrence B. Grissom

Lawrence B. Grissom

cc: Les Girard ✓

EXHIBIT # 54

Meet & Confer 2002

Union Presidential Leave & Retirement Benefits
Current Status of Union Presidents

Union	President	Status
POA	Bill Farrar	Full-time Union president Unpaid Leave from City.
Local 145	Ron Saathoff	Full-time employee. Release time for Union activities.
MEA	Judie Italiano	Full-time Union president. Unpaid Leave from City.
Local 127	Tony Padilla	Full-time employee. Release time for Union activities.

47

Meet & Confer 2002

Union/President	Employment Status	Retirement Issue
MEA Judie Italiano	- Leave of Absence 14 years - Payroll Specialist - Full-time MEA President & General Manager	-Purchased past service - Contributes to Retirement on Union Salary ($102,128) - Retirement formula = high one year on union salary *
POA Bill Farrar	- Leave of Absence 2 years - Police Officer II - Full time POA President	- All Service Paid - Contributes to Retirement on union salary ($82,300) - Retirement formula = high one year on union salary *

* Approximate un-funded Liability

Judie Italiano	$145,000
Bill Farrar	$56,000

48

EXHIBIT # 55

Meet & Confer 2002

~~Union Presidential Leave & Retirement Benefits~~

~~Issue 1 – Current Union Presidents~~

Management Team Recommendation:

- Authorize inclusion of union salary in high one-year calculation; establish a maximum retirement high one-year salary at level equal to City Labor Relations Manager (approx. $108k)

49

Meet & Confer 2002

~~Union Presidential Leave & Retirement Benefits~~

~~Issue 2: Prospective Union Presidents~~

Management Team Recommendations:

- City to allow each union to have a full-time City-paid union President
- Union President/employee to be paid for normal work period at current level and receive current benefits with *no* overtime
- Union President to be entitle to retirement benefits consistent with his/her classification and level of compensation
- Union may compensate the union president for services to the union outside the normal work period. Such compensation shall not affect or be a part of City compensation, nor affect or add to retirement benefits
- Subject to final review and clearance by City Attorney

Estimated Cost: $170,000 annually for two active presidents

50

Meet & Confer 2002

~~Union Presidential Leave & Retirement Benefits~~

Issue 3 – Requested Presidential Leave for Local 145

Union/President	Employment Status	Retirement Issue
Local 145 Ron Saathoff	- Full-time City employee - Fire Captain	- Use City salary and union salary for high one year calculation (approx. $80k + $40k = $120k) - No retirement contribution made on union salary*

*Approximate Unfunded Liability $100,000

51

Meet & Confer 2002

~~Union Presidential Leave & Retirement Benefits~~

Issue 3 – Requested Presidential Leave for Local 145

Management Team Recommendation:

- Treat current President under Issue 2; do not authorize inclusion of union salary in high one-year calculation.

Alternative:

Treat current President under Issue 1, combine City salary and Union salary; cap retirement high one-year salary at level equal to City Labor Relations Manager (approx. $108k)

52

CLOSED SESSION REPORT [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: _____

[STAMP HERE]

TITLE Labor negotiations - meet and confer
labor negotiations DCAs Rivo/Marshall

DATE OF CLOSED SESSION: 4/30, 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: _____

ATTENDEES:
[X] City Mgr [X] Asst City Mgr [X] Sr Dep City Mgr (Loveland)
[X] City Atty [X] Exec Asst City Atty [X] Asst City Atty (Girard)
[X] City Auditor
[X] Other Bruce Herring, Pat Frazier, Dan Kelley, Stan Griffith, Terri Webster, Rich Snapper, Elmer Heap, Mike Rivo, Cathy Lexin, Mike McGhee, Sharon Marshall

[] PUBLIC SECURITY THREAT G.C. § 54957

[] VOTE [X] NO VOTE NECESSARY

COMMENTS: _____

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

APPROVED: _____

NOTE: (D) DISCLOSE FOLLOWING CLOSED SESSION

L:\LDEVANEY\CLSDSESS\04_30_02\mtncfr.frm

EXHIBIT # 56

Meet & Confer 4/30

Presidential leave

A) MEA & PSA 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.

CLOSED SESSION REPORT [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: _____
(STAMP HERE)

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: [signature]

NOTE: (D) DISCLOSE FOLLOWING CLOSED SESSION

EXHIBIT # 57

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

SAN DIEGO CITY ATTORNEY
CASEY GWINN

LESLIE E. DEVANEY
Executive Assistant City Attorney
(619) 236-6220 • (619) 236-7215 (FAX)

MEMO

Overall Economic Proposal — Slide 17

CD1 Moves Mgr's Recommendation
CD7 2nd

450 '04 } plus } 9-0
450 '05 }

MEA
Change salary increase '03 to lock in 7/02 Y- N-

~~MEA~~

* Presidential Leave
CD 7 - Mtn - Mgr's recommendation
9-0

MEA SSA except Labor Mgr. 9-0
127 — 9-0
145 9-0

DIVERSITY

Meet & Confer 2002

Retirement Issues:

- *Presidential Leave and Retirement Benefits*
- Funding Ratio Impact on City Contribution
- 2.5% at 55 General Member Formula
- Increases in Employee Pick-ups
- Retiree Health Insurance and Funding

35

Meet & Confer 2002

Union Presidential Leave & Retirement Benefits

Current Status of Union Presidents

Union	President	Status
POA	Bill Farrar	Full-time Union president Unpaid Leave from City.
Local 145	Ron Saathoff	Full-time employee. Release time for Union activities.
MEA	Judie Italiano	Full-time Union president. Unpaid Leave from City.
Local 127	Tony Padilla	Full-time employee. Release time for Union activities.

36

Meet & Confer 2002

Union Presidential Leave & Retirement Benefits

Current Status of Union Presidents

Union/President	Employment Status	Retirement Issue
MEA **Judie Italiano**	- Leave of Absence 14 years - Payroll Specialist - Full-time MEA President & General Manager	-Purchased past service - Contributed to Retirement on Union Salary ($102,128) - Expects Retirement formula = high one year on union salary *
POA **Bill Farrar**	- Leave of Absence 2 years - Police Officer II - Full time POA President	- All Service Paid - Contributed to Retirement on union salary ($82,300) - Expects Retirement formula = high one year on union salary *

* Approximate un-funded Liability		
	Judie Italiano	$145,000
	Bill Farrar	$56,000

37

Meet & Confer 2002

Union Presidential Leave & Retirement Benefits

Issue 1 – Current Union Presidents

Management Team Recommendation:

1. Authorize inclusion of union salary in high on year calculation; establish a maximum retirement high one-year salary at level equal to City Labor Relations Manager (approximately $108,000 currently)

38

Meet & Confer 2002

Union Presidential Leave & Retirement Benefits
Issue 2: Current Local 145 President

Management Team Recommendation:

1. Allow the current Local 145 President to begin a paid Presidential Leave under the terms described in Issue 2 effective July 1, 2002
2. Allow contributions on union salary in addition to the City's contributions on Captain's salary, to a max of $108,000 for the one year period prior to July 1, 2002 to establish a high one year

39

Meet & Confer 2002

Union Presidential Leave & Retirement Benefits
Issue 3: Prospective Union Presidents

Management Team Recommendations:

1. Authorize full-time City-paid union Presidential Leave for each of the 4 unions beginning July 1, 2002
2. Union President/employee to be paid for normal work period at the salary of their current class when become President; receive regular benefits for the class; with *no* overtime
3. Retirement benefits consistent with his/her classification and level of compensation
4. Union may compensate the union president for services to the union outside the normal work period. Such compensation shall not affect or be a part of City compensation, nor affect or add to retirement benefits

40

AF

CITY OF SAN DIEGO
MEMORANDUM

RECEIVED
MAY 24 2002
COUNCIL MEMBER
JIM LAFFER

DATE: May 24, 2002

TO: Honorable Mayor & City Council

FROM: Daniel E. Kelley, Labor Relations Manager

SUBJECT: Final Three Year offer to San Diego Police Officers Association

---

Attached are the documents that comprised the City's final three-year offer to the San Diego Police Officers Association (POA), which was rejected by the POA Negotiating Team.

Attachment 1 reflects the City's final offer for a three-year agreement that was presented to the POA on May 9, 2002. Attachment 2 reflects the Cities modified position as a result of the changes authorized by Council as a result of the impasse hearing.

If you would like additional information or detail on specific changes, please call the Labor Relations Office at (619) 236-6313.

Daniel E. Kelley
Labor Relations Manager

Mm

cc: Michael T. Uberuaga, City Manager
Lamont Ewell, Assistant City Manager
Cathy Lexin, Human Resources Director

Attachments

EXHIBIT # 58

CONFIDENTIALITY REQUESTED UNDER LETTER OF MARCH 2, 2004

City of San Diego and Police Officers Association
May 9, 2002

Attachment 1

Following is a Summary of the City's Final Position if the parties reach agreement on a three year Memorandum of Understanding by May 13, 2002.

Substantial benefit improvements granted by the City since the adoption of the "City Manager's Retirement Proposal" dated July 23, 1996 (Manager's Proposal) have created additional un-funded liability to SDCERS that was not anticipated when the City agreed to the "trigger" provisions.

Significant improvements in benefits are contained in this three-year proposal. Consequently, the "trigger" provisions must be adjusted as a condition of the City's three-year proposal, therefore, this three year proposal is contingent upon, and subject to, approval by the SDCERS Board of Trustees of an adjustment to the "trigger" provisions contained in the Manager's Proposal, Issue #3, Paragraph B, to read as follows:

> "B. *The floor for the actuarial funded ration of SDCERS will be established at 75% contingent upon the approval of the Retirement Board.*
>
> *The City will pay contributions at the agreed rates shown above for FY 96 through FY 07. In any year the actuarial funded ratio falls below the floor, the City will increase its contribution rate on July 1 of the following year. The increase in the City contribution rate will be in the amount necessary to restore the funded ratio to the floor. However, at no time will the increase in the City contribution rate exceed 20% of the difference between the agreed rate and the actuarially recommended rate.*
>
> *Once the City contribution rate has been increased as described above, it will increase by .50% annually until such time as it is equal to the actuarially recommended rate calculated under the Entry Age Normal (EAN) method. From that time forward, the City contribution rate will be calculated under the EAN method.*

<u>No changes to Articles:</u> 3, 6, 7 10, 11, 12, 14, 15, 17, 20, 21, 22, 23, 27, 29, 30, 31, 33, 34, 35; 36, 37, 38, 39, 42, 43, 46, 47, 49, 50, 52, 54, 56, 57, 58, 59, 60, 61, 62

<u>Tentative Agreement on changes to the following Articles:</u>
Article 1 – Parties to the Agreement
Article 2 – Recognition
Article 4 – Term
Article 5 – Renegotiation
Article 13 – Flexible Benefits Plan
Article 16 – Bilingual Pay
Article 19 – Sick Leave & Annual Leave Reimbursement
Article 24 – Grievance Procedure
Article 26 – Uniforms
Article 28 – Field Training Officer Pay
Article 40 – Flight Pay

CONFIDENTIALITY REQUESTED UNDER LETTER OF MARCH 2, 2004

NATIONAL STEEL AND SHIP
A GENERAL DYNAMICS COMPANY

RICHARD H. VORTMANN
PRESIDENT

AUDITOR & COMPTROLLER
CITY OF SAN DIEGO
RECEIVED
2002 JUN 25 PM 4:26

June 24, 2002

Dictated but not read by R.H. Vortmann

Mr. Fred Pierce — **Via e-mail**
Mr. Lawrence Grissom — **Via e-mail**

Copy to all San Diego City Employee Retirement System Board Members — **Via regular mail**

Dear Board Members:

Below are a series of questions which I would like to see answered and discussed at our next meeting.

1. We need to expand the data analysis which we received to be able to compare the improvement in annual funding rate the City is offering against what would happen **if** the 82% floor is violated:

   A. Three alternative interpretations of the remedy should be shown:

      1) Immediately in one year fund enough to get back to 82% (and what is the annual funding thereafter??)

      2) Immediate increase of annual funding rate to actuarial annual rate.

      3) "Fred's theory"

2. Given everyone's (on-the-Board, Counsel, Actuary) feeling the Board should not be put in the middle of labor negotiations, particularly when we now become the "go - no go," ask the City Manager to come and explain why they put the Board in this position; why it was necessary; and given their "lessons learned" how do they intend to conduct union negotiations in the future differently to prevent a reoccurrence of this inappropriate situation.

3. Ask the City to explain to the Board a clear statement of **why** they feel it is necessary to **violate** their previous '96 agreement. (Cathy said this has nothing to do with the benefits improvements.) What is so compelling to violate the '96 safeguard? Is not that why the safeguard was part of the '96 deal?

4. Ask the City to tell us their plan to deal with Retiree health in the future. This is critical since **if** they expect the Trust to salt away sufficient money from excess earnings each year, to make current payments plus to build up a reserve to cover medical payments in years where there is no excess earnings assumption.

2798 HARBOR DRIVE • SAN DIEGO, CA 92113 • PO. BOX 85278 • SAN DIEGO, CA 92186-527.
TELEPHONE (619) 544-8600 • FAX (619) 544-3541 • E-MAIL: dvortman@nassco.

EXHIBIT # 59

We need to know this **now** because it is another (and significant) negative impact on the funding ratio which is key to our deliberations of giving relief on the 82% "trigger".

5. Ask the City to explain to the Board why we should assume the City will find it easier to pay **much** higher annual Pension costs in the future than it has found itself able or desirous to pay the last 5 years (the first 3 of which were "boom" economic years with property tax, sales tax, and T.O.T. all rising rapidly).

   Ask the City to share this financial cost projection of how much more money they will need find in their budget in FY '08 for pensions. (I compute this as follows.)

	FY'01	FY'08	
Payroll	$479m	$720m	(6%/yr increase covering head count growth of 3% and inflation of 3%
Contribution Rate	9.83%	13.89%	
Contribution $	$47m	$103m	

(Obviously a huge increase)

   We need to **know** this as a key input in deciding whether to give relief to the City on their prior deal and thereby "grant them credit."

6. Ask the City to speak to the basic issue here:

   The City has chosen to increase employee benefits. City was also stuck with an unexpected lawsuit (but such lawsuit had its origins in a previous benefit increase which was not fully understood by the City). These improvements in benefits are **not** the problem. The problem is very simply that the City does **not** want to **pay** currently for what they want to give the employees. They clearly are addicted to the "give now, pay later" or "burden the future year's taxpayers" when they no longer have any say in the decision – i.e. the decision being locked down now, with the mandatory bill being paid later.

   Since the City is in essence asking the Board to be an "enabler" to the City in their "addiction", the Board at least deserves to hear everybody enunciate the **truth** – not a bunch of smoke about tough economic times, the State is screwing us, etc.

7. What would the actuarial annual contribution rate be **if** it properly reflected the **fact** that annual contributions will be less than the actuarial computations assume?

8. What are all the known (or reasonable expected) changes to the components of the actuarial calculation which will hit in the next 1-3 years?

Can we proforma "what ifs" on these possibilities to see what it does to the funding ratio and the annual contribution rate?

We need to know this to form a judgement as to the probability of falling below the 82%.

9. Clearly show a table with the following:

	Current	If monies are moved from actuarial assets to medical account	Include Corbet	Include adjustment of earnings assumption for siphoning off of excess earnings
Funding Ratio				
Annual Contribution Rate				

10. We need from counsel a clear explanation of the '96 trigger remedy.

    A. What are the different "theories"?

    B. What could the Board enforce on the City? How?

    C. If the City and Board selected one interpretation, are we vulnerable to a lawsuit?

11. Need a **comprehensive** discussion on liability of Trustees:

    A. What indemnity exist?

        1) Is it "City may", or "City will"?

        2) What exceptions are there where City won't?

        3) Will City pay our legal cost to litigate whether they **should** indemnify?

        4) Will City pay all our legal costs in general, as incurred?

        5) Dollar limits on indemnity?

12. We need see in advance of the meeting Counsel's final legal **opinion** on whether they believe an approval of the Revised Manager's Proposal would meet our fiduciary responsibility. We are not asking the **what** to do, just **if** we did it would it pass muster?

Sincerely,

Dictated but not read by Mr. Vortmann

Richard H. Vortmann
President

RHV/lh

CITY OF SAN DIEGO
MEMORANDUM

DATE: July 3, 2002

TO: Lawrence B. Grissom, Retirement Administrator

FROM: Bruce Herring, Deputy City Manager

SUBJECT: City's Proposal Regarding Contribution Rates and Reserves and Responses to Questions From SDCERS Trustees

---

This report supplements the Manager's Reports to the San Diego City Employees Retirements System (SDCERS) Board of Administration dated June 10 and June 18. The purpose of this report is to:

1. Provide more specific language describing the proposed modification to the Manager's Proposal of 1996/97 related contribution rates;

2. Provide responses to the questions from SDCERS Trustees, Fiduciary Counsel and Actuary regarding the proposed modification; and

3. Transmits reports regarding the City's financial strength and credit-worthiness.

The Proposal

The 1996/97 Manager's Proposal provides that the City's "agreed to" contribution rate will increase 0.50% each fiscal year until the City is paying the PUC actuarial rate, then continue with 0.50% increases until the City is paying the EAN actuarial rate.

This proposed modification would increase the City's agreed to rate by 1.00% beginning in FY05, projecting to reach the PUC actuarial rate by FY09, then continuing with 0.50% annual increases, but no less than the PUC rate, until the EAN rate is achieved.

It is also proposed that the funded ratio floor be amended to 75% from 82.3%, and if the floor is effectuated, the City would begin paying at a rate that would achieve full PUC actuarial rate within five years, but no later than FY09. Once at PUC, the City would continue with 0.50% increases until the EAN rate is achieved.

EXHIBIT # 60

The proposed modification would result in one of the following scenarios:

1. The City paid rate would increase 0.50% in FY03, increase 0.50% in FY04 plus +1.06%, the cost of the 2.5% at age 55% formula; then increase 1.00% beginning in FY05, and continue with 1.00% increases until the City is paying the PUC rate, then continue with 0.50% increases until the City is paying the EAN actuarial rate. Apparently, this was not clear in our earlier reports.

2. Or, if the funded ratio floor of 75% is triggered, beginning the following July 1, the City's agreed to contribution rate would increase by the amount that is 20% of the difference between the current paid rate and the full PUC actuarial rate. Once the PUC rate is reached, the City would continue with 0.50% increases in rates until EAN is reached. Under this scenario, the "gap" would be measured at each valuation period and any necessary adjustments to the agreed to rate would be made to ensure the full PUC rate is achieved within the five year period.

As indicated in our June 10 and June 18 reports, the cost of any new benefits which may be considered by the City in the future, would not be absorbed, but paid for in addition to the agreed to City rates.

Questions from Trustees

Attachment 1 provides responses to the questions from Trustees which were directed to the City.

City's Financial Strength

Attachments 2 through 6 provide third party analytical reports demonstrating the city's fiscal strength, credit worthiness and financial management practices for which it has received statewide and national recognition.

Respectfully submitted,

Bruce Herring
Deputy City Manager

Attachments: 1 Response to Questions from Trustees
2- 6 Financial Reports (green pages)

Attachment 1

Questions from Trustee Richard H. Vortmann directed to the City (numbered to coincide with the numbers on Mr. Vortmann's correspondence dated June 24, 2002.

2. **Ask the Manager to explain why the Board was put in the middle of labor negotiations, and how we will conduct union negotiations in the future differently to prevent this inappropriate situation.**

The proposal before the SDCERS Board of Trustees is not asking the Board to get in the middle of labor negotiations. Labor negotiations are over and complete. The action requested of the Board deals with the relationship between the City as plan sponsor, and the Board.

Labor representatives and Management representatives are members of the SDCERS Board by City Charter design. This is a common make up for retirement boards, and part of the environment that we must operate within even if uncomfortable.

The City must adopt the annual Salary Ordinance by May 14 each year pursuant to the City Charter (Section 11.1).

The City reached agreement with three of its labor organization on May 13, 2002. Two of those labor organizations identified the 2.50% at age 55 General Member formula improvement as one of its, if not the, top priority for labor negotiations. Other retirement enhancements were also included in the negotiations.

Retirement benefits is an appropriate subject of bargaining. The City must maintain a competitive compensation package to attract and maintain qualified employees to serve its constituents. The determination of what constitutes a competitive compensation package is a matter appropriate for the City, its negotiators and its labor organizations.

Neither the SDCERS Board, staff, nor consultants are the appropriate entities to determine what level of compensation and benefits should be established. The City is not asking the SDCERS Board nor its consultants to "get in the middle" of negotiations.

The City for reasons stated in our June 10 report, was and continues to be concerned about its fiscal situation. The 2.50% at age 55 formula will cost the City's budget beginning in FY04 and ongoing.

The City became aware via the June 30, 2001 actuarial valuation, first produced as a draft on February 12, 2002, that the funding ratio for June 30, 2001 was 89.9% and that the blended employer contribution effective July 1, 2002 would jump from a blended rate of 12.58% for FY2002 to 15.59% for FY2003.

Aware of the effect of the market decline and reduced SDCERS earnings during FY2002, the City developed concern about a further decline in the funded ratio for the June 30, 2002 valuation and became concerned about the effect of "triggering" the full actuarial rates in FY04 contemplated in the 1996/97 Manager's Proposal.

The City, through labor negotiations, agreed that the 2.50% at age 55 is an appropriate benefit to bestow. The City, however, was not willing to grant this benefit, given the cost, if at the same time, it might be facing a jump in retirement contribution rates to full actuarial rate (+$25million) as a result of the "trigger". Consequently, the City agreed *contingent* upon the resolution in this proposal.

The City did not set out to place the SDCERS Board in an uncomfortable situation. The interrelatedness of issues is inherent in the make up of the Board which is established in the City Charter. Such make up is common on public agency retirement boards.

The City is working to address the declining funding ratio. The City and SDCERS should approach this situation as partners toward a mutual objective of properly funding its retirement system

3. **Why does the City feel it is necessary to violate their previous agreement? What is so compelling? Is not that why the safeguard was part of the '96 deal?**

The City is not asking to violate the previous agreement. The City is proposing a modification and seeking approval from SDCERS, in response to the different set of circumstances before us today. In 1996, all parties evaluating the proposal assumed that the full actuarial rates (PUC) would be reached by FY08 using the 0.50% steady, predictable increase per year. None of the parties believe that can occur without a modification.

The SDCERS Board minutes from 1996 when the 1996/97 Manager's Proposal was approved, quote the actuary (Mr. Roeder at that time as well) as follows:

> "Mr. Roeder responded that he would have been reluctant to recommend this plan without some sunset provisions. However, he states that he believes that this is a sound proposal as long as the funded ratio does not drop significantly, and with the appropriate sunset provisions."

Two sunset provisions were included in 1996; one time-based and one funded-ratio based. The City committed to be at full actuarial (PUC) rate by FY09, and established a funded ratio sunset of 10% below the FY96 ratio. Mr. Roeder states in the June 1996 minutes "that the funded ratio as of June 30, 1995 was 93.5% (this included the PORT and the City rate would have be lower). "If this proposal is put into place, he estimated that the funded ratio would drop by 5% of whatever the ratio would have been, absent any benefit improvements. (This assumed a starting ratio of less than 88.5%, and a 10% lower floor expected to be less than 78.5%). The proposed modification to a 75% floor is not significantly different than what was anticipated to be the floor in 1996 when the original agreement was approved by SDCERS.

More important, this modification provides substantial certainty that the City's contribution rate will reach the full actuarial rate (PUC) by FY2009, and doubles the incremental increases in City rate contributions for the next five (5) years.

4. **Ask the City to tell us their plan to deal with Retiree health insurance in the future.**

The City of San Diego is in the situation as every other employer with respect to the escalating cost of health insurance. We are working with our labor organizations, our insurance brokers and consultants and our legislators to address this national crisis.

More specifically to this proposal, in 1996 the voters of San Diego amended the City Charter (Proposition D, by a 72.33% margin) related to retiree health insurance. Proposition D (Attachment 1-a) read:

> "Rather than paying for health insurance benefits to retired City employees directly from the City's operating funds, as is the current practice, shall San Diego City Charter Section 171 be amended to authorize the City Council to provide these benefits through the San Diego City Retirement System."

The ballot argument from which the voters approved this measure explicitly stated that retiree health insurance would be paid from "excess earning to cover the full costs of workers' retirement health benefits."

In responding to a question from Trustee Casey at the June 1996 SDCERS meeting regarding the retiree health insurance element of the Manager's Proposal, Mr. Grissom stated that "what is visualized in this proposal is a pay-as-you-go basis that could be projected with fair accuracy at the beginning of the year using the premium costs for the coming year. The Board would have the duty to set up the reserves to provide for that funding. If those reserves are exceeded, i.e. brought down to zero, then the responsibility for the cost of the benefit would revert back to the City."

The City's proposal today to transfer $25m from FY2000 excess earnings is consistent with the 1996/97 agreement and the Charter amendment.

5. **Explain 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. The circumstances in 1996/97 and projections by all involved have changed. We are responding to those changes as is our duty and consistent with the City's express intent in 1996. When asked about the potential of higher than anticipated actuarial rate increases, then City Manager Jack McGrory stated:

"Mr. McGrory stated that the practical reality is that if the City observes that the rate is increasing higher than what was projected, in 2002 or 2003 the City would step in at that time to determine how they will deal with the issue. He stated that the ramp-up would become accelerated because the City wold not want to be in a position of having to deal with a balloon payment in the year 2009."

The City's current proposal does just what the City promised to do in 1996. Last year's funding ratio was 97.3%. There was no reason for the City to address this issue prior to seeing the actuary's valuation delivered a few months ago.

6. **Ask the City to speak to the basic issue here:**

The City has chosen to increase benefits.

True, and appropriate in its role of employer.

City was also stuck with an unexpected lawsuit (but such lawsuit had its origins in a previous benefit increase which was not fully understood by the City).

The Corbett litigation (assuming this is the reference) had its origins in the *Ventura County Sheriff's* litigation. The City disagrees with Mr. Vortmann's characterization that this litigation related to a previous benefit increase not fully understood by the City.

These improvements in benefits are not the problem.

The City and SDCERS were each sued under Corbett. Neither the City nor SDCERS anticipated the effects of *Ventura County Sheriff's* nor *Corbett*. *Corbett* asserted that the base compensation for calculating retirement benefits should include a variety of additional elements (overtime, flex benefits, accrued vacation, etc.) never included by the actuary in the costing of City nor employee contribution rates. Consequently, when the settlement was reached, the result was a monumental past liability to the City, estimated at $150 million. Settlement avoided an exposure to the System estimated at the time to be $750 million. The Corbett settlement clearly impacted the funding ratio of the system.

City is addicted to "give now, pay later" or "burden the future year's taxpayers". The Board deserves to hear the truth, not a bunch of smoke about tough economic times, the State is screwing us etc."

The City disagrees with this perception. The City has endeavored to maintain an adequately funded retirement system. Employee retirement benefits are by their very nature paid in the future, when employees retire, for service performed today. Given its legal obligation to pay these benefits, the City has a strong motivation to address the funded ratio decline and is doing so by this proposal and by our expressed intent to continue working on a long term funding plan.

Notwithstanding its financial/credit strength and reputation for strong financial management practices, the City, the County and the State of California are all in the throws of serious, tough economic times. The nation's economic downturn is evident in the investment market, in tourism and travel, etc. Of immediate concern is the State's financial downturn and the likely implications to City's and Counties. Various proposals at the State level being discussed could impact the City's revenues by $20 million to $40 million in FY04. This is a real situation which has been the subject of much publicity, and remains unresolved.

The City of San Diego continues to be recognized for its excellent performance in municipal finance. This does not mean that the City is not facing serious challenges with budget issues. Current taxpayers expect continued *and* enhanced municipal services and facilities, and do not want increases in taxes or fees. San Diego continues to be independently rated as an efficiently run City with a low ratio of employees to citizens. If San Diego is to expect this level of performance from its workforce, it must maintain a competitive position in compensation.

The proposal before the SDCERS Board reflects a fiscally responsible approach to attaining the full actuarial rate at a date specific within the time frame contemplated in the current agreement between the City and SDCERS.

10. **We need from counsel a clear explanation of the '96 trigger remedy.**
What are the different "theories"?
What could the Board enforce on the City? How?
If the City and Board selected one interpretation, are we vulnerable to a lawsuit?

The City Manager representatives (Mr. Herring and Ms. Lexin) who negotiated the agreement, and the SDCERS Administrator, Mr. Grissom who represented SDCERS in the 1996 agreement all confirmed the "trigger" remedy as the City paying the full actuarial rate beginning the year following the "trigger" occurring.

The June 21, 1996 SDCERS minutes (the date that SDCERS approved the 1996/97 Manager's Proposal) quote Mr. Grissom responding to the question might not the gap between agreed to rates and actuarial rates widen.:

> "...Paragraph C in the proposal states that if you arrive at the year 2009 and that gap has not been closed, the City's contribution rate would increase at that point from wherever it currently is to the actuarial rate."

Mr. Roeder, the SDCERS actuary then and now, confirms this remedy as well on page 16 of his June 30, 2002 valuation just adopted by the SDCERS Board. Mr. Roeder states under Comment G on Page 16:

> "Part of the Manager's Proposal stipulates that the full actuarial rate would be paid if the funded ratio falls below 82.3%"

Attachment 2
Fitch Rating Agency:
May 28, 2002 upgraded the City to its highest general obligation credit rating of AAA

Attachment 3
Moody's Investors Service Rating Agency
May 2002 maintained the City's general obligation bonds at Aa1

Attachment 4
Standard & Poor's Agency
May 20, 2002 maintained the City's general obligation bonds at AA

Attachment 4A
Legend for Rating Agency Long Term Credit Ratings

Attachment 5
Calderon, Jaham and Osborn Independent Auditor's Report
Unqualified "clean" opinion on the City's general-purpose financial statements as of June 30, 2001
(Full report available on the City's website)
The City has received an unqualified opinion for at least the last ten years.

Attachment 6
February 2002 Blue Ribbon Committee Report on the City Finances - Executive Summary
(Full report available on the City's website)

4.5 copy
MP2 projector

ATTORNEY TO CLIENT
CORRESPONDENCE

FOR CONFIDENTIAL USE ONLY

CITY OF SAN DIEGO
MEMORANDUM

7/09/02
ITEM #4

DATE: July 8, 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 and Proposal to SDCERS

BACKGROUND

Attached is the modified proposal to SDCERS approved in closed session on June 14, 2002 and presented to the SDCERS Board at their meeting of Friday, June 21, 2002.

DISCUSSION

On Friday, June 21, the SDCERS Board considered the City's modified proposal regarding City contribution rates and the 75% funded ratio "trigger." The Board spent three hours discussing this proposal, and eventually trailed the matter to a special meeting to be scheduled for mid July. A meeting is scheduled exclusively for this matter on Thursday, July 11, 2002.

Of major concern to the SDCERS Board contributing to the continuance of this matter was the lack of a final written report from their outside fiduciary counsel. The "draft" report from fiduciary counsel published for the June 21, 2002 meeting was quite negative, clearly erring on the side of caution due to the fact that counsel, from his perspective, did not have time to evaluate the proposal sufficiently to render final advice. This was exacerbated by the delivery of a letter from Michael Aguirre threatening to litigate if the Board approved the proposal.

The Manager's Office has been in ongoing discussions with the Retirement Administrator attempting to provide answers and clarification to questions from SDCERS Board Members, the fiduciary counsel and actuary.

EXHIBIT # 61

A final written report from fiduciary counsel was anticipated last Wednesday, then Friday, then Monday. It was our intent to brief you today on the contents of fiduciary counsel report, and if necessary seek any further modification necessary to achieve approval from SDCERS regarding the City's retirement contribution rates.

RECOMMENDATION

While we still have not seen the fiduciary counsel's final report , conversations with the Retirement Administrator lead us to be optimistic about a favorable report. The Manager's Office intends to present the modified proposal at the SDCERS meeting of July 11, and respond to any additional questions which may arise.

Based on our conversations with the Retirement Administrator, we anticipate a motion from a Board member which would further modify the proposal before the Board, by eliminating the request to lower the funded ratio floor, and including the five year phase-in if the trigger (82.3% funded ratio) is effectuated.

Given the importance of avoiding a immediate full rate implementation (versus five year phase in), it is recommended that the Council authorize staff to agree to this modification should the proposal currently before SDCERS not prevail. If this additional modification is necessary, staff would ask that if the funded ratio trigger occurs in the upcoming June 30, 2002 valuation, that the phase in of full actuarial rates not begin until FY05.

If this modification is acceptable to the Board and Fiduciary Counsel, the practical impact on the City would be no different than the previously authorized City position. Under either scenario, there would not be any increase to the City contribution rate until FY05.

Attachment

CLOSED SESSION REPORT [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: _____

[STAMP HERE]

TITLE Labor negotiations - Meet and Confer retirement matters (HDCA HEAP)

DATE OF CLOSED SESSION: 7/9, 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)
[ ] City Atty [X] Exec Asst City Atty [X] Asst City Atty (Noone)
[X] City Auditor
[X] Other Bruce Herring, Rich Snapper, Sharon Marshall, Cathy Lexin, Dan Kelley

[X] VOTE [] NO VOTE NECESSARY

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

COMMENTS: Authorize modification of proposal - leave trigger at 82% of funding but 1 year grace period to pay (retirement formula), but only as back-up if original proposal (75% trigger) fails at Retirement Board

APPROVED: _____

NOTE: (D) DISCLOSE FOLLOWING CLOSED SESSION

EXHIBIT # 62

L:\LDEVANEY\CLSDSESS\07_09_02\mtncfr.wpd

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

CONSENT MOTION BY MADAFFER TO ADOPT. 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-133: Two actions related to Approval of Agreements on SDCERS Board Indemnification & City SDCERS Employer Contributions.

CITY MANAGER'S RECOMMENDATION:

Adopt the following resolutions:

Subitem-A: (R-2003-390) ADOPTED AS RESOLUTION R-297335

Declaring that the City of San Diego agrees to defend, indemnify and hold harmless the members of the Board of Administration for the San Diego City Employees' Retirement System in the performance of their duties.

Subitem-B: (R-2003-661) ADOPTED AS RESOLUTION R-297336

Authorizing the City to enter into an agreement with the San Diego City Employees' Retirement System regarding employer contributions.

CITY MANAGER SUPPORTING INFORMATION:

Board Indemnification: Section 141 of the San Diego City Charter created the San Diego City Employees' Retirement System (SDCERS). Section 144 provides that SDCERS be administered by a thirteen (13) member governing board known as the Board of Administration (Board), which includes three members elected by the General Members of SDCERS, one member elected by the retirees of SDCERS, two members elected by the Safety Members of SDCERS, one Police, one Fire, respectively, three ex-officio members: City Manager, City Auditor, and City Treasurer, and four citizen members, one of which must be an officer of a local bank, are appointed by the Council and serve without compensation. Charter Section 144 grants the Board the sole authority to determine the rights and benefits eligibility from SDCERS, administer SDCERS, and invest the SDCERS trust fund; SDCERS Board Members may, from time to time, be subjected to claims and suits for actions taken in their capacity as such.

Due to the need to protect and encourage individuals who volunteer their time and their talent to serve in the public interest, approval of the resolution provides that 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.

Employer Contributions: On June 7, 1996, the City proposed and the SDCERS Board of Administration ("Board") agreed to the City Manager's Retirement Proposal, as modified, ("Manager's Proposal") dated July 21, 1996. The Manager's Proposal sets out agreements between the City and SDCERS with respect to contributions to be made by the City to SDCERS starting in Fiscal Year 1996. As a result of the recently concluded meet and confer process, the City and the Board recognize that under the current method of determining City contributions to SDCERS, the annual level of contributions has the potential to become volatile and SDCERS' funding ratio has decreased in recent years. The City and the Board also recognize 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. In response to those concerns, on June 18, 2002, the City requested the Board agree to an amended Manager's Proposal. On July 11, 2002, the Board approved modifications to the Manager's Proposal. This Agreement is entered into in order to provide a transition period for City contributions to be brought, by Fiscal Year 2009, to the full contribution rates that would be applied if the projected unit credit funding method were used, to provide accelerated contributions by the City if SDCERS' funding ratio goes below 82.3% before the end of the term of this Agreement, and to terminate all transition arrangements regarding contributions with the City at the end of Fiscal Year 2009. The attached agreement describes the current and proposed contribution arrangements.

Herring/Kelley

FILE LOCATION: SUBITEMS A & B: MEET

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

CONSENT MOTION BY MADAFFER TO ADOPT. 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.

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.

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.)

Sec. 240.10b-5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by th use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

(Sec. 10; 48 Stat. 891; 15 U.S.C. 78j)

[13 FR 8183, Dec. 22, 1948, as amended at 16 FR 7928, Aug. 11, 1951]

EXHIBIT # 67

curity if, prior to such loan, arrangement, or failure to deliver, the exchange upon which the sale requiring the delivery of such security was effected finds (i) that such sale resulted from a mistake made in good faith, (ii) that due diligence was used to ascertain that the circumstance specified in § 240.10a-1 (c) (1) existed or to obtain the information specified in § 240.10a-1 (c) (2) and (iii) either that the condition of the market at the time the mistake was discovered was such that undue hardship would result from covering the transaction by a "purchase for cash", or that the mistake was made by the seller's broker and the sale was at a price permissible for a short sale under § 240.10a-1 (a) (Sec. 10a, 48 Stat. 891; 15 U. S. C. 78j (a)) [Rule X-10A-2]

CROSS REFERENCE: For interpretative release applicable to § 240.10a-2, see § 241.1571 of this chapter.

MANIPULATIVE AND DECEPTIVE DEVICES AND CONTRIVANCES

§ 240.10b-1 *Prohibition of use of manipulative or deceptive devices or contrivances with respect to certain securities exempted from registration.* The term "manipulative or deceptive device or contrivance," as used in section 10 (b) (48 Stat. 891, 15 U. S. C. 78j (b)), is hereby defined to include any act or omission to act with respect to any security exempted from the operation of section 12 (a) (48 Stat. 892; 15 U. S. C. 78l (a)) pursuant to any section in this part which specifically provides that this section shall be applicable to such security, if such act or omission to act would have been unlawful under section 9 (a) (48 Stat. 889; 15 U. S. C. 78i (a)) or any rule or regulation heretofore or hereafter prescribed thereunder, if done or omitted to be done with respect to a security registered on a national securities exchange, and the use of any means or instrumentality of interstate commerce or of the mails or of any facility of any national securities exchange to use or employ any such device or contrivance in connection with the purchase or sale of any such security is hereby prohibited. (Sec. 10, 12; 48 Stat. 891, 892, 15 U. S. C. 78j, 78l) [Rule X-10B-1]

CROSS REFERENCES: For applicability of this section, see §§ 240.12a-1 to 240.12a-9. For regulations relating to employment of manipulative and deceptive devices, see § 240.10b-3 and 10b-5. For prohibitions with respect to securities not registered on a national securities exchange, see § 240.10b-4.

§ 240.10b-2 *Solicitation of purchases on an exchange to facilitate distribution of securities.* (a) No person, participating or otherwise financially interested in the primary or secondary distribution of any security of any issuer, shall, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange:

(1) Pay or offer or agree to pay, directly or indirectly, to any person any compensation for soliciting another to purchase any security of the same issuer on a national securities exchange, or for purchasing any security of the same issuer on any such exchange for any account other than the account of the person who pays or is to pay such compensation; or

(2) Sell, offer to sell or induce an offer to buy such security, or deliver such security after sale, if, in connection with such distribution, such person has paid, or has offered or agreed to pay, directly or indirectly, to any person, any compensation for soliciting another to purchase any security of the same issuer on any national securities exchange, or for purchasing any security of the same issuer on any such exchange for any account other than the account of the person who has paid or is to pay such compensation.

(b) No person, participating or otherwise financially interested in the primary or secondary distribution of any security of any issuer, shall cause a purchase or sale of any security of the same issuer on a national securities exchange by paying or offering or agreeing to pay, directly or indirectly, to any person any compensation for soliciting another to purchase such security on any such exchange, or for purchasing such security on any such exchange for any account other than the account of the person who pays or is to pay such compensation.

(c) The provisions of this section shall not apply in respect to any salary paid by a broker or dealer to any person regularly employed by him whose ordinary duties include the solicitation or execution of brokerage orders on a national securities exchange, if such salary represents only ordinary compensation for the discharge by such person of such duties in the regular course of his employment, and is not paid, in whole or in part, directly or indirectly, for the inducement by such person of the purchase or sale on a national securities exchange of any security of the issuer of the security in the primary or secondary distribution of which such broker or dealer is participating or otherwise financially interested.

(d) (1) The provisions of this section shall not apply to any transaction involving the payment of a special commission to a person acting as a broker for a purchaser by a person selling any security described in this paragraph, where such payment is made pursuant to the terms of an effective plan authorizing the payment of special commissions in connection with a distribution of securities, which plan has been filed with the Commission by a national securities exchange: *Provided,* That such person, at the time he pays, or offers or agrees to pay, any such commission does not know or have reasonable grounds to believe that transactions connected with such distribution are being carried out in violation of such plan. This exemption shall be available only in respect of securities listed and registered on a national securities exchange, or of securities admitted to unlisted trading privileges on any such exchange where the issuer (i) has any security listed and registered on any such exchange and has filed the annual and other periodic reports required pursuant to the Securities Exchange Act of 1934 (48 Stat. 88, et seq., 15 U. S. C. 78a-hh), or (ii) has any security registered under the Securities Act of 1933 (48 Stat. 74, et seq., 15 U. S. C. 77a-aa) and has filed the annual and other periodic reports required pursuant to section 15 (d) of the Securities Exchange Act of 1934 (49 Stat. 1377; 15 U. S. C. 78o), or (iii) is a holding company registered under the Public Utility Holding Company Act of 1935 (49 Stat. 803, et seq., 15 U. S. C. 79a-Z-5) and has filed the annual and other periodic reports required pursuant to such Act, or a subsidiary of any such company, or (iv) is registered under the Investment Company Act of 1940 (54 Stat. 789, et seq., 15 U. S. C. 80a-1-53) and has filed the annual and other periodic reports required pursuant to such act.

(2) For the purposes of this rule a plan filed with the Commission by a national securities exchange shall not become effective unless the Commission, having due regard for the public interest and for the protection of investors, declares the plan to be effective. The Commission in its declaration may impose such terms and conditions relating to the provisions of the plan and the period of its effectiveness as it deems necessary or appropriate in the public interest or for the protection of investors. (Sec. 10, 48 Stat. 891; 15 U. S. C. 78j) [Rule X-10B-2]

CROSS REFERENCE: For interpretative release applicable to § 240.10b-2, see § 241.1411 of this chapter.

§ 240.10b-3 *Employment of manipulative and deceptive devices.* It shall be unlawful for any broker or dealer, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, to use or employ, in connection with the purchase or sale of any security otherwise than on a national securities exchange, any act, practice, or course of business defined by the Commission to be included within the term "manipulative, deceptive, or other fraudulent device or contrivance", as such term is used in section 15 (c) (1) of the act. (Sec. 10, 48 Stat. 891, sec. 2, 52 Stat. 1075; 15 U. S. C. 78j, 78l) [Rule X-10B-3]

CROSS REFERENCES: See also § 240.10b-5. For regulation relating to prohibition of manipulative or deceptive devices, see §§ 240.10b-1. For the term "manipulative, deceptive, or other fraudulent device or contrivance" as used in section 15 (c) (1) of the act, see §§ 240.15c-2 to 240.15c1-9.

§ 240.10b-5 *Employment of manipulative and deceptive devices by any purchaser of a security.* It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud.

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

HeinOnline -- 13 Fed. Reg. 8183 1948

in connection with the purchase or sale of any security. (Sec. 10; 48 Stat. 891, 15 U. S. C. 78j) [Rule X-10B-5]

EXEMPTION OF CERTAIN SECURITIES FROM SECTION 11 (d) (1)

§ 240.11d1-1 *Exemption of certain securities from section 11 (d) (1)* A security shall be exempt from the provisions of section 11 (d) (1) with respect to any transaction by a broker and dealer who, directly or indirectly, extends or maintains or arranges for the extension or maintenance of credit on the security to or for a customer if:

(a) The broker and dealer has not sold the security to the customer or bought the security for the customer's account; or

(b) The security is acquired by the customer in exchange with the issuer thereof for an outstanding security of the same issuer on which credit was lawfully maintained for the customer at the time of the exchange; or

(c) The customer is a broker or dealer or bank; or

(d) The security is acquired by the customer through the exercise of a right evidenced by a warrant or certificate expiring within 90 days after issuance, provided such right was originally issued to the customer as a stockholder of the corporation issuing the security upon which credit is to be extended, or as a stockholder of a company distributing such security in order to effectuate the provisions of section 11 of the Public Utility Holding Company Act of 1935. The right shall be deemed to be issued to the customer as a stockholder if he actually owned the stock giving rise to the right when such right accrued, even though such stock was not registered in his name; and in determining such fact the broker and dealer may rely upon a signed statement of the customer which the broker and dealer accepts in good faith; or

(e) Such broker and dealer would otherwise be subject to the prohibition of section 11 (d) (1) with respect to 50% or less of all the securities of the same class which are outstanding or currently being distributed, and such broker and dealer sold the security to the customer or bought the security for the customer's account on a day when he was not participating in the distribution of any new issue of such security. A broker-dealer shall be deemed to be participating in a distribution of a new issue if (1) he owns, directly or indirectly, any undistributed security of such issue, or (2) he is engaged in any stabilizing activities to facilitate a distribution of such issue, or (3) he is a party to any syndicate agreement under which such stabilizing activities are being or may be undertaken, or (4) he is a party to an executory agreement to purchase or distribute such issue. (Sec. 3, 11, 48 Stat. 882, 891, 15 U. S. C. 78c; 78k) [Rule X-11D1-1]

SECURITIES EXEMPTED FROM REGISTRATION

§ 240.12a-1 *Temporary exemption from section 12 (a) of the act of certain securities of banks.* (a) The following securities of banks shall be exempt from the operation of section 12 (a) of the act to and including the one hundred and twentieth day after the filing of applications on the form appropriate for such securities shall be authorized: (1) Securities as to which temporary registration expired on June 30, 1935; (2) securities of the same issuer heretofore or hereafter issued in exchange for, or resulting from a modification of any securities exempted from the operation of section 12 (a) of the act by this section; and (3) additional shares of common stock, heretofore or hereafter issued, if common stock of the same issuer and of the same class is exempted from the operation of section 12 (a) of the act by this section.

(b) Sections 240.7c2-1 and 240.10b-1 shall be applicable to all securities exempted from the operation of section 12 (a) of the act by this section. (Secs. 3 (a) (12), 12 (a) 48 Stat. 882, 892; 15 U. S. C. 78c (a) (12) 78l (a)) [Rule X-12A-1]

§ 240.12a-2 *Temporary exemption from section 12 (a) of the act of certain securities secured by property which, or a leasehold interest in which, is owned by a person not the original issuer of such security; prohibition of use of manipulative or deceptive devices or contrivances with respect thereto.*

(a) Any security which is secured by property which, or a leasehold interest in which, is now owned by a person who was not the original issuer of such security, shall be exempt from the operation of section 12 (a) of the act (48 Stat. 892; 15 U. S. C. 781 (a)) to and including the respective dates indicated below, and for such longer period, if any as would have been applicable under § 240.12a-1 or § 240.12a-3, if such security had been a security of such owner or lessee:

(1) If temporary registration of such security expired on June 30, 1935, such exemption shall continue to and including November 5, 1935, unless either of the following conditions is satisfied, in which event such exemption shall continue to and including April 30, 1936:

(i) An application for the registration of such security has been filed by the original issuer or by such owner or lessee.

(ii) Such owner or lessee has filed with the exchange and with the Commission a statement conforming to the requirements of paragraph (b) of this section as the same existed prior to this amendment.

(2) If such security was listed on an exchange at the time a temporary exemption from registration was granted to such exchange, and shall have continued to be so listed until registration of such exchange became effective, such exemption shall continue to and including April 30, 1936.

If registration pursuant to section 12 (b) (c) and (d) (48 Stat. 892, 893; 15 U. S. C. 781 (b) (c) (d)) shall become effective as to any obligation evidenced by any such security, such exemption shall forthwith terminate as to such obligation.

(b) Any security exempted by paragraph (a) of this section from the operation of section 12 (a) of the act shall continue to be exempt from the operation of said section 12 (a) to the extent necessary to render lawful the effecting of transactions therein on any national securities exchange on which such security is now listed, until this section shall be revoked, or modified, if on or before the twentieth day preceding the expiration of the exemption provided by said paragraph (a) the owner or lessee of the property securing the same shall file with such exchange, and with the Commission, a statement with respect to such security or, if such owner or lessee is personally liable upon such security, an application for the registration of such security, conforming to the following requirements. Such statement or application, as the case may be, shall be made upon the form appropriate for registration of securities of such owner or lessee, shall set forth the information required by such form, and shall contain the following additional statement with respect to such security:

(1) That temporary registration of such security expired on June 30, 1935;

(2) That such security is secured by property which is owned or leased by such owner or lessee and, if leased, a brief outline of the principal provisions of such lease, together with a copy of such lease as an exhibit;

(3) That the original issuer has either been dissolved or has no assets (other than nominal assets) except its interest, if any, in such property, and that such security has as its only means of service payments made by such owner or lessee; and

(4) Whether or not such owner or lessee is personally liable upon such securities.

If any such statement or application does not contain the additional statement and exhibit required in subparagraphs (1)-(4) of this paragraph, such additional statement and exhibit may be supplied in an amendment, pursuant to § 240.12b-3, filed on or before such twentieth day. Any such security may be included in any application made by such owner or lessee for the registration of its own securities, provided that it is clearly indicated that the required additional statement is made for the purposes of this section.

If registration pursuant to section 12 (b) (c) and (d) of the act shall become effective as to any obligation evidenced by any such security, such exemption shall forthwith terminate as to such obligation.

(c) Sections 240.7c2-1, 240.10b-1 shall be applicable to all securities exempted from the operation of section 12 (a) of the act by paragraph (a) or (b) of this section. (Secs. 3 (a) (12), 12 (a), 48 Stat. 882, 892; 15 U. S. C. 78c (a) (12), 78l (a)) [Rule X-12A-2]

CROSS REFERENCE: For applicability of this section and §§ 240.12a-1, 240.12a-3 to securities listed on exempted exchange which subsequently becomes registered, see § 240.6b-3.

§ 240.12a-3 *Temporary exemption from section 12 (a) of the act of certain securities of issuers in bankruptcy or receivership or in process of reorganization, prohibition of use of manipulative or deceptive devices or contrivances with respect thereto.* (a) The following securities shall be exempt from the operation of section 12 (a) of the act for the period specified in paragraph (b) of this

HeinOnline -- 13 Fed. Reg. 8184 1948

Welcome to HeinOnline

Knowingly inducing or receiving discriminating price under 2 (f) § 3.850 *Inducing and receiving discriminations.* In or in connection with the purchase of food products or other items of merchandise in commerce, knowingly inducing or receiving from any manufacturer or seller, by or through means of any coupon or other similar device, any discount, rebate, or other allowance higher than, or any price lower than, that allowed by such manufacturer or seller to competitors of the respondent, when such coupon or other device results in a discrimination in favor of the respondent; prohibited.

(Sec. 6, 38 Stat. 722; 15 U. S. C. 46. Interprets or applies sec. 2, 38 Stat. 730, as amended; 15 U. S. C. 13) [Modified cease and desist order, National Tea Co. et al., Docket 5646, May 8, 1951]

In the Matter of National Tea Company, a Corporation, and National Tea Company-Standard Grocery Division, a Corporation

This proceeding having been heard by the Federal Trade Commission upon the complaint of the Commission and the substitute answer of the respondent, National Tea Company, in which answer said respondent admitted all of the material allegations of fact set forth in the complaint and waived all intervening procedure and further hearing as to said facts; and the Commission, having made its findings as to the facts and its conclusion that the respondent had violated subsection (f) of section 2 of an act of Congress entitled "An act to supplement existing laws against unlawful restraints and monopolies, and for other purposes," approved October 15, 1914 (the Clayton Act) as amended by the Robinson-Patman Act, approved June 19, 1936 (15 U. S. C., sec. 13) on May 16, 1950, issued, and on May 22, 1950, served upon said respondent, its order to cease and desist. Thereafter, this matter came on for hearing before the Commission upon a petition, filed on behalf of the respondent, requesting certain modifications in the aforesaid order to cease and desist, and the answer to such petition, filed by counsel in support of the complaint, and the Commission, having entered its order granting the respondent's petition, now issues this its modified order to cease and desist.

It is ordered, That the respondent, National Tea Company, a corporation, and its officers, agents, representatives and employees, directly or through any corporate or other device, in or in connection with the purchase of food products or other items of merchandise in commerce, as "commerce" is defined in the aforesaid Clayton Act, do forthwith cease and desist from:

Knowingly inducing or receiving from any manufacturer or seller, by or through means of any coupon or other

complaint herein be, and it hereby is, dismissed as to National Tea Company-Standard Grocery Division.

It is further ordered, That the respondent, National Tea Company, shall, within sixty (60) days after service upon it of a copy of this order, file with the Commission a report in writing setting forth in detail the manner and form in which it has complied with this order.

Issued: May 8, 1951.

By the Commission.

[SEAL] D. C. DANIEL, *Secretary.*

[F. R. Doc. 51-9470; Filed, Aug. 10, 1951; 9:23 a. m.]

TITLE 17—COMMODITY AND SECURITIES EXCHANGES

Chapter II—Securities and Exchange Commission

PART 240—RULES AND REGULATIONS UNDER SECURITIES EXCHANGE ACT OF 1934

CORRECTION

In the reprint of the rules and regulations under the Securities Exchange Act of 1934, certified on December 15, 1949, and printed at 13 F. R. 8197 et seq., the headnote of § 240.10b-5 should be corrected to read *"Employment of manipulative and deceptive devices."*

[SEAL] ORVAL L. DUBOIS, *Secretary.*

AUGUST 6, 1951.

[F. R. Doc. 51-9471; Filed, Aug. 10, 1951; 8:47 a. m.]

TITLE 24—HOUSING AND HOUSING CREDIT

Chapter II—Federal Housing Administration, Housing and Home Finance Agency

Subchapter B—Property Improvement Loans

PART 203—TITLE I MORTGAGE INSURANCE; ELIGIBILITY REQUIREMENTS

INCREASED MORTGAGE AMOUNT AND TERM ON ACCOUNT OF MAJOR DISASTERS

Part 203 is hereby amended by adding the following new § 203.20c:

§ 203.20c *Increased mortgage amount and term on account of major disasters.* In any case where the mortgagor is the owner and occupant of a property upon which there is located a dwelling designed principally for a single-family residence, the construction or reconstruction of which was begun after April 29, 1950, and which was approved for mortgage insurance prior to beginning of construction or reconstruction, and the mortgagor establishes (to the satis-

insurance is filed wi
the date of such
mortgage may, no
other provision of t
principal amount m
except that the Com
crease this amount
$8,000 in any geogr
he finds that cost le
not to exceed 100
praised value of the
be for a term not in

(Sec. 2, 48 Stat. 1246, a
1703. Interprets or a
Law 475, 81st Cong.)

Issued at Washing
1951.

[SEAL] FRANKLI
Federal Housi

[F. R. Doc. 51-9319;
8:45 a

TITLE 26—INTE

Chapter I—Bureau
nue, Department

Subchapter A—Income o
[Regulati

PART 24—CONSOLIDAT
CESS PROFITS

Corre

In Federal Registe
published at page 6
Friday, June 29, 195
16 F. R. 7620, the
should be made. In
agraph (5) (middle
should read as follo

(5) *Limitation on*
operating loss carry-
putation of the cons
ing loss deduction fo
if there is involved a
sustained in a prior
tion filing a separat
prior year, or joinin
return for such prio
other affiliated grou
consolidated net op
there are involved ne
two or more membe
separately sustained,
consolidated net ine
dated return period
vening between the y
the taxable year shal
count more than one
the provisions of par
of this section, relati
tion of the consolid
loss carry-overs orig
return years.

TITLE 32—NATI

http://www.heinonline.org/HOL/Page?collection=fedreg&handle=hein.fedreg/016156&id= 2/8/2005

11/26/03

Maco Terri's Quicks notes

miami case --- related to CAFR footnote
misleading disclosure --- found footnote to
be fraudent. In ruling we get the message:
* Even though something is immaterial per
GAAP it can still be in violation
of anti-fraud law.

Paul M. can see how Paul W could find
these errors material due to (1) quantity
(2) The big error on leases (3) lack of
solid processes on city & CJO that
didn't catch this stuff ---
loose ~~credible~~ Credibility

Therefore

1. Do ~~reco~~ advise putting in transmittal
letter see attached.

To be cautious 2. Do file voluntarily with NEMRS the
Paul W. language from POS
or wait on CAFR and get POS out ~~be~~ at same date as
CAFR (once POS out CAFR is out since in it)

3. Do put reference on web site to NEMRS

~~will tell you more to be con~~ end of notes since have to leave work

EXHIBIT # 68

CLOSED SESSION REPORT [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 Number of cases: one (Henderson v. City) anticipated litigation (ACA Girard)

DATE OF CLOSED SESSION: 11/6, 2001

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

[X] LITIGATION G.C. § 54956.9
[](a) Pending [X](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)
[X] 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: _____

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

ATTENDEES:
[X] City Mgr [X] Asst City Mgr [X] Sr Dep City Mgr (Loveland)
[X] City Atty [X] Exec Asst City Atty [X] Asst City Atty (Girard)
[X] City Auditor
[X] Other _Bond Counsel, SEC Counsel, Theresa McAteer, Kelly Salt, Pat Frazier, Bruce Herring, Mike Madigan

[] VOTE [X] NO VOTE NECESSARY

COMMENTS: _____

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

APPROVED: _____

NOTE: (D) DISCLOSE FOLLOWING CLOSED SESSION

EXHIBIT # 69

L:\L.DEVANEY\CLSDSESS\Nov_6_01\henderson.wpd

ATTORNEY TO CLIENT
CORRESPONDENCE
FOR CONFIDENTIAL USE ONLY

Office of
The City Attorney
City of San Diego

MEMORANDUM
MS 59

(619) 236-6220

DATE: November 6, 2001

TO: Honorable Mayor and Members of the City Council

FROM: Leslie J. Girard, Assistant City Attorney

SUBJECT: Furgatch v. San Diego Unified Port District, et al., Court of Appeal D035842; City, et al. v. All Persons Interested, et al., San Diego Superior GIC 763487; Dunkl v. City, et al., U.S. Supreme Court No. 01-136; Skane v. City, et al., San Diego Superior GIC 752505; and anticipated litigation matter: Henderson v. City

---

In closed session we will be discussing with you your responsibilities regarding the consideration of the Preliminary Official Statement for the City's ballpark bonds. Our outside counsel, Gerald Boltz and Matt Anhut of Bryan Cave LLP, along with the City's bond counsel, Paul Webber of Orrick Herrington & Sutcliffe LLP, will be discussing these matters with you. Enclosed, for your review prior to the closed session, is a memorandum from Mr. Boltz and Mr. Anhut that generally outlines federal securities laws on this subject.

Enclosure

BRYAN CAVE LLP

ST. LOUIS, MISSOURI
WASHINGTON, D.C.
NEW YORK, NEW YORK
KANSAS CITY, MISSOURI
OVERLAND PARK, KANSAS
PHOENIX, ARIZONA
IRVINE, CALIFORNIA

120 BROADWAY, SUITE 300
SANTA MONICA, CALIFORNIA 90401-2305
(310) 576-2100
FACSIMILE: (310) 576-2200

RIYADH, SAUDI ARABIA
KUWAIT CITY, KUWAIT
ABU DHABI, UNITED ARAB EMIRATES
DUBAI, UNITED ARAB EMIRATES
HONG KONG
SHANGHAI, PEOPLE'S REPUBLIC OF CHINA
IN ASSOCIATION WITH BRYAN CAVE, A MULTINATIONAL PARTNERSHIP, LONDON, ENGLAND

GERALD E. BOLTZ
DIRECT DIAL NUMBER
(310) 576-2134

INTERNET ADDRESS
GEBOLTZ@BRYANCAVE.COM

MATTHEW D. ANHUT
DIRECT DIAL NUMBER
(310) 576-2144

INTERNET ADDRESS
MDANHUT@BRYANCAVE.COM

October 29, 2001

Leslie J. Girard, Esq.
Assistant City Attorney
City of San Diego
Civil Division - Special Projects
1200 Third Avenue, Suite 1620
San Diego, CA 92101

Privileged and Confidential
Attorney-Client Communication

Re: Review of Disclosure Documents as to Lease Revenue Bonds 2001

Dear Les:

We are writing this letter to provide an overview of the applicable federal securities laws and to provide a framework against which the City Council for the City of San Diego ("City Council") and the Board of Commissioners of the Public Facility Financing Authority of the City of San Diego ("Board of Commissioners") must review and evaluate the Preliminary Official Statement ("POS"), and the Official Statement when completed, prepared in anticipation of the offering of the Lease Revenue Bonds 2001 ("2001 Bonds"). As noted in the POS, the purpose of the bond offering is to finance the construction of a major league baseball park in San Diego, as well as other uses (as described in the POS) relating to the ballpark project (the "Ballpark Project"). In this letter we will not recount the lengthy history relating to the Ballpark Project and the numerous related legal challenges and actions, except to note, however, that in a letter dated September 20, 2001, to the City Attorney, the lawyer who has been the driving force behind various pieces of litigation relating to the Ballpark Project has contended that, because of various changes and alterations, the Ballpark Project should be re-submitted to the voters of San Diego for approval (the "September Letter").

In light of the application of provisions of the federal securities laws, and in particular the obligations imposed on issuers in connection the offering and sale of securities (as described below), and the allegations made in the September Letter, each member of the City Council and the Board of Commissioners must read the POS (and when completed the Official Statement), ask questions as to any area or matter that may seem unclear or need clarification, actively seek

information from the officials of the City or Authority and professionals retained in connection with the proposed offering, and conduct follow-up as to the information supplied.

Overview of the Applicable Federal Securities Laws

While Congress exempted offerings of municipal securities, such as the 2001 Bonds, from the registration requirements of the Securities Act of 1933, and the system of periodic reporting under the Securities Exchange Act of 1934, it did not exempt transactions in municipal securities from the antifraud provisions of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder. These provisions prohibit any person, including municipal issuers, from making a false or misleading statement of material fact, or omitting any material facts necessary to make statements made by that person not misleading, in connection with the offer, purchase or sale of any security. In the event of a violation of the securities provisions, the SEC has a range of remedies at its disposal, including the authority to seek injunctive relief to stop (in extraordinary circumstances) the offer or sale of securities and the imposition of penalties (which include monetary fines and the placement of limitations on securities related activities). In addition, there is typically a substantial amount of negative publicity that arises in connection with an SEC proceeding.

Although as to certain antifraud provisions, the SEC must show that the person acted with "scienter" -- that is recklessness or an intent to deceive, manipulate, or defraud -- the SEC need only demonstrate that the person acted negligently to establish a violation of other antifraud provisions. To establish negligence, the SEC must show that the defendants failed to conform with the standard of care that a reasonable person would have exercised in like circumstances and position. Of course, there must first be a misstatement or omission of a material fact; however, the lower threshold of negligence provides greater enforcement flexibility to the SEC.

In light of the foregoing, it is critical that the City Council and the Board of Commissioners exercise all due care in reviewing and evaluating the information contained in the POS. As to that information, the statements in the POS "must be viewed as part of a 'mosaic' to see if those statements, in the aggregate, created a misleading impression. . . . The proper test is not the literal truth or the materiality of each positive statement, but the overall misleading impression that it combines to create." *In re Genentech, Inc., Securities Litigation*, 1989, Fed. Sec. L. Rep. (CCH) ¶94, 544 (N.D. Cal. 1989). Moreover, a fact is deemed "material" if there is a " ... substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable [investor]. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

Unfortunately, in the event that there is a challenge to the adequacy of a disclosure document, such challenge occurs with the benefit of hindsight. While it is not appropriate to apply hindsight, as a practical matter it is sometimes difficult to disregard subsequent events, and the impact of those events, in placing the disclosure in the proper context of what had occurred as of the time that the document was created.

The importance of the review of municipal securities disclosure documents was highlighted in connection with an SEC report that was critical of the supervisors of Orange County, California for shortcomings relating to their review of such documents. *Report of Investigation in the Matter of County of Orange, California as it Relates to the Conduct of the Members of the Board of Supervisors,* Exchange Act Release No. 36761 (January 24, 1996). As stated by the SEC in the Orange County matter:

> In authorizing the issuance of securities and related disclosure documents, a public official may not authorize disclosure that the official knows to be false; nor may a public official authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading. When, for example, a public official has knowledge of facts bringing into question the issuer's ability to repay the securities, it is reckless for that official to approve disclosure to investors without taking steps appropriate under the circumstances to prevent the dissemination of materially false or misleading information regarding those facts. **In this matter, such steps could have included becoming familiar with the disclosure documents and questioning the issuer's officials, employees or other agents about the disclosure of those facts.**

Id. (emphasis added).

The message communicated by the statements of the SEC in the foregoing report is that members of the body approving disclosure documents cannot simply "rubber-stamp" the document. Rather, each member has the responsibility to demonstrate that he or she was actively involved in the process -- that is, each person must review the disclosure document, inquire as to the source of the information, ask questions of the City officials and other professionals who provided information (as well as ask if there are other sources of information that should be reviewed), and follow-up to ascertain whether the information makes sense in the circumstances. In short, the members of the City Council and the Board of Commissioners must demonstrate that they have satisfied themselves, after diligent inquiry that all material facts have been accurately disclosed, that the POS is not misleading.

Application of the Provisions of Federal Securities Laws to the POS

As discussed above, the primary consideration in regard to the POS is that it not contain a misstatement as to a material fact or omit to state any fact that is necessary so as to make the

statements contained therein not misleading. This standard does not mean that the members of the City Council and the Board of Commissioners cannot rely on the professionals and City officials who have supplied information to be included in the POS. What it does mean, however, is that the members of the City Council and the Board of Commissioners act with reasonable care. This includes, at a minimum: (1) reviewing the entire POS; (2) asking for clarification as to material parts of the POS that a member may need additional guidance; (3) seeking information and asking questions of the officials, employees, and professionals who supplied information to be included in the POS; and (4) asking follow up questions to determine the reasonableness of any assumptions or estimates that were used in the POS. Although significant efforts have been expended to make the information in the POS accurate and understandable, the members of the City Council and the Board of Commissioners should not be hesitant to inquire as to any area that might not be entirely clear.

Also, in light of prior challenges to the Ballpark Project, it is prudent that the City Council make certain that there are no additional disclosure issues that need to be addressed. In particular, the City Council should document whether there is any potential conflict of interest -- whether through a business or financial relationship or transaction -- that might need to be disclosed. In this regard, we recommend that the City Council document that each member has not received anything of value from the Padres, any affiliate of the Padres, or any other person or entity that has a material interest in either the Ballpark Project or the proposed offering of the 2001 Bonds. (Such persons include: Padres, L.P.; Padres Construction, L.P.; Mr. John Moores; JMI Realty, Inc.; JMIR - Downtown Acquisition, LLC; San Diego Ballpark Builders; Clark Construction Group, Inc.; Nielsen Dillingham Builders; Douglas E. Barnhart, Inc.; Hines Interests Limited Partnership; Major League Baseball; Ambac Assurance Corporation; Wells Fargo Corporate Trust; HOK Sports; Merrill Lynch & Co., Inc.; Morgan Stanley & Co., Inc.; I.C. Rideau Lyons & Co.; Redwood Securities Group.)

From the perspective of the securities laws, no precise criteria can be established as to the level or range of financial and business relationships, arrangements and practices that might be problematic. The better practice is to ensure that there is no potential conflict in the first instance by requesting and obtaining written confirmation from each member that he or she did not have any business or financial dealings with any person who might be interested in the Ballpark Project or the 2001 Bond offering.

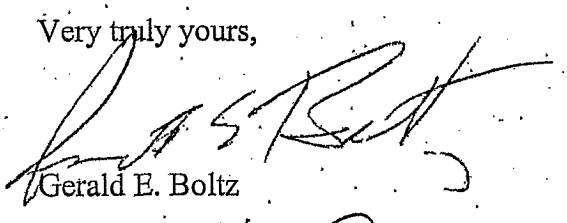
Finally, the City Council should, as part of its review, address the allegations made in the September Letter. In particular, in the September Letter, the lawyer asserts that changes in the financing and revenue assumptions relating to the Ballpark Project and the ancillary development; the increase in the financial participation by the Redevelopment Agency, the reliance by the City on other revenue sources for the Ballpark Project, any amendments to the MOU, and the change in the scope of the ancillary development mandate that the project again be submitted to the voters of the City for approval. Further, and notwithstanding that the POS had

not been completed or released prior to the date of his letter, the lawyer stated that matters might be "omitted or misstated in the [POS]."

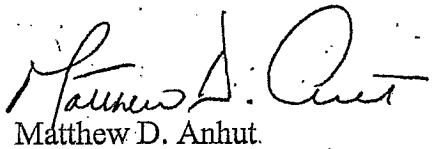
In regard to the allegations made by in the September Letter, portions of the POS relating to the Plan of Financing, the Redevelopment Project, the Risk Factors and Litigation should receive additional attention on review by the City Council and the Board of Commissioners. In particular, the lawyer asserts that the transient occupancy tax and tax increment to be generated from the hotels, office space and other development around the Ballpark Project will not be sufficient to pay for the City's contribution to the Ballpark Project. While the assertion rests upon the assumption that specific revenues were pledged for the project, the allegations highlight the importance of reviewing the financial projections and assumptions underlying the City's commitment and resources available to repay the bonds. In that regard, the members of the City Council and the Board of Commissioners should make use of the resources available through City officials in determining whether any of the assertions warrant further attention.

Although there can be no prediction of what future actions might be brought relating to the Ballpark Project or the offering of the 2001 Bonds, a thorough and careful review of the POS by the members of the City Council and the Board of Commissioners will provide a solid foundation to support any response to -- and hopefully summarily conclude -- potential, future challenges.

Very truly yours,



Gerald E. Boltz



Matthew D. Anhut

ATTORNEY TO CLIENT
CORRESPONDENCE
FOR CONFIDENTIAL USE ONLY

Office of
The City Attorney
City of San Diego

MEMORANDUM
MS 59

(619) 236-6220

DATE: October 23, 2001

TO: Honorable Mayor and Members of the City Council

FROM: Leslie J. Girard, Assistant City Attorney

SUBJECT: Potential Litigation: Henderson v. City

You may recall that Bruce Henderson recently sent a letter to the City Attorney setting forth numerous complaints about the Ballpark Project [Project]. In that letter, a copy of which is attached, he threatens either further litigation or a complaint to the Securities and Exchange Commission [SEC] regarding the potential Preliminary Official Statement [POS] for the City's bonds.

In closed session we will discuss with you some of the matters raised in Mr. Henderson's complaint and the impact his continued threats of litigation are having on the Project. Preparing for his inevitable litigation or SEC complaint has delayed the presentation of the POS to the City Council while a number of matters are addressed. These matters include: 1) the need for a further extension of the MOU; 2) the need for an agreement from Major League Baseball [MLB Guaranty], as a condition of obtaining municipal bond insurance, guarantying a significant portion of the Padres' funding obligation for the Project; and 3) the impact of the delay on the cost of the Ballpark (borne by the Padres) and the financing of the Westin Hotel. The discussion will include a recommendation regarding the treatment of the City's first priority lien and security interest in the Padres' franchise in light of the MLB Guaranty, and a recommendation regarding the length of the necessary extension of the MOU.

AICPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Codification of Statements on Auditing Standards

(Including Statements on Standards for Attestation Engagements)

Numbers 1 to 93

EXHIBIT # 70

Outstanding Statements on Auditing Standards

SAS No.	Title	AU Section
1	Codification of Auditing Standards and Procedures	See Part III of Cross-References to SASs section
8	Other Information in Documents Containing Audited Financial Statements	550
12	Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments	337
22	Planning and Supervision	311
25	The Relationship of Generally Accepted Auditing Standards to Quality Control Standards	161
26	Association With Financial Statements	504
29	Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents	551
31	Evidential Matter	326
32	Adequacy of Disclosure in Financial Statements	431
37	Filings Under Federal Securities Statutes	711
39	Audit Sampling	350
41	Working Papers	339
42	Reporting on Condensed Financial Statements and Selected Financial Data	552
43	Omnibus Statement on Auditing Standards	150; 331; 350; 420; 901
45	Omnibus Statement on Auditing Standards—1983	313; 334
46	Consideration of Omitted Procedures After the Report Date	390
47	Audit Risk and Materiality in Conducting an Audit	312
48	The Effects of Computer Processing on the Audit of Financial Statements	311; 326
50	Reports on the Application of Accounting Principles	625
51	Reporting on Financial Statements Prepared for Use in Other Countries	534
52	Omnibus Statement on Auditing Standards—1987	551; 558
54	Illegal Acts by Clients	317
55	Consideration of Internal Control in a Financial Statement Audit	319
56	Analytical Procedures	329
57	Auditing Accounting Estimates	342
58	Reports on Audited Financial Statements	508
59	The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern	341
60	Communication of Internal Control Related Matters Noted in an Audit	325
61	Communication With Audit Committees	380
62	Special Reports	623
64	Omnibus Statement on Auditing Standards—1990	341; 508; 543
65	The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements	322
67	The Confirmation Process	330
69	The Meaning of *Present Fairly in Conformity With Generally Accepted Accounting Principles*	411
70	Service Organizations	324
71	Interim Financial Information	722
72	Letters for Underwriters and Certain Other Requesting Parties	634
73	Using the Work of a Specialist	336
74	Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of	

AICPA

.08 In other cases the auditor may determine that a point estimate is a better estimate than any other amount. In those situations, the auditor would use that amount to determine the reasonableness of the recorded amount. The auditor would compare the point estimate to the amount recorded by the client and include any difference in the aggregation of misstatements.[2]

.09 Section 312.36 indicates that the auditor should be alert to the possibility that management's recorded estimates are clustered at either end of the auditor's range of acceptable amounts, indicating a possible bias on the part of management. Section 312.36 states, in part—

> The auditor should also consider whether the difference between estimates best supported by the audit evidence and the estimates included in the financial statements, which are individually reasonable, indicate a possible bias on the part of the entity's management. For example, if each accounting estimate included in the financial statements was individually reasonable, but the effect of the difference between each estimate and the estimate best supported by the audit evidence was to increase income, the auditor should reconsider the estimates taken as a whole. In these circumstances, the auditor should reconsider whether other recorded estimates reflect a similar bias and should perform additional audit procedures that address those estimates. In addition, the auditor should be alert to the possibility that management's recorded estimates were clustered at one end of the range of acceptable amounts in the preceding year and clustered at the other end of the range of acceptable amounts in the current year, thus indicating the possibility that management is using swings in accounting estimates to offset higher or lower than expected earnings. If the auditor believes that such circumstances exist, the auditor should consider whether these matters should be communicated to the entity's audit committee, as described in section 380, *Communication With Audit Committees*, paragraphs .08 and .11.

[Issue Date: December, 2000.]

3. Quantitative Measures of Materiality in Evaluating Audit Findings

.10 *Question*—Section 312, *Audit Risk and Materiality in Conducting an Audit*, provides guidance to the auditor on evaluating the effect of misstatements on the financial statements under audit. Section 312.10 states, in part—

> The auditor's consideration of materiality is a matter of professional judgment and is influenced by his or her perception of the needs of a reasonable person who will rely on the financial statements.

Section 312.34 further describes the auditor's evaluation of the quantitative aspects of materiality. It states, in part—

> In evaluating whether the financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles, the auditor should aggregate misstatements that the entity has not corrected in a way that enables him or her to consider whether, in relation to individual amounts, subtotals, or totals in the financial statements, they materially misstate the financial statements taken as a whole.

---

[2] See Interpretation No. 14, "Reasonable Estimation of the Amount of a Loss" of FASB Statement No. 5, *Accounting for Contingencies*.

What factors should the auditor consider in assessing the *quantitative* impact of identified misstatements?

.11 *Interpretation*—The quantitative evaluation of identified misstatements is a matter of professional judgment and should reflect a measure of materiality that is based on the element or elements of the financial statements that, in the auditor's judgment, are expected to affect the judgment of a reasonable person who will rely on the financial statements, considering the nature of the reporting entity. For example, it is generally recognized that after-tax income from continuing operations is, in most circumstances, the measure of greatest significance to the financial statement users of entities whose debt or equity securities are publicly traded. Depending on the entity's particular circumstances, other elements of the financial statements that may be useful in making a quantitative assessment of the materiality of identified misstatements include current assets, net working capital, total assets, total revenues, gross profit, total equity, and cash flows from operations. In all instances, the element or elements selected should reflect, in the auditor's judgment, the measures most likely to be considered important by the financial statement users.

.12 *Question*—An entity's after-tax income or loss from continuing operations may be nominal or may fluctuate widely from year to year due to the inclusion in the results of operations of significant, unusual, or infrequently occurring income or expense items. What other quantitative measures could be considered if after-tax income or loss from continuing operations is nominal or fluctuates widely from period to period?

.13 *Interpretation*—In certain circumstances, a quantitative measure of materiality based on after-tax income from continuing operations may not be appropriate. The auditor may identify another element or elements that are appropriate in the circumstances or may compute an amount of current-year after-tax income from continuing operations adjusted to exclude unusual or infrequently occurring items of income or expense.[3]

.14 The selection of an alternate element or elements for use in assessing a quantitative measure of materiality is a matter of the auditor's professional judgment. In choosing an alternate element or elements, the auditor should evaluate the perceived needs of the financial statement users, the particular circumstances that caused the abnormal results for the current year, the likelihood of their recurrence, and any other matters that, in the auditor's judgment, may be relevant to a quantitative assessment of materiality.

[Issue Date: December, 2000.]

4. Considering the Qualitative Characteristics of Misstatements

.15 *Question*—Section 312, *Audit Risk and Materiality in Conducting an Audit*, paragraph .34, states, in part—

> Qualitative considerations also influence the auditor in reaching a conclusion as to whether misstatements are material.

What qualitative factors should the auditor consider in assessing whether misstatements are material?

---

[3] Paragraph 26 of APB Opinion No. 30, *Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary*

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.

EXHIBIT # 71

Paul Webber disagreed. While the City focused on the fact that the errors were not quantitatively material, largely because few of them tied to the City's balance sheet, Mr. Webber viewed the existence of so many errors, and the outside auditors' failure to catch them, as a breakdown in the reporting process that was in itself material:

> I believe that the errors and the corrections thereof is information that needs to be disclosed in the Official Statement. While you and the auditors may conclude that the errors and corrections as such were not material either individually collectively, what I believe is material from a disclosure standpoint is the fact that somehow the process broke down permitting that to happen . . . and what has the City done[.][358]

E. The Voluntary Disclosure

The tensions between Mr. Webber and various members of City staff grew as he wrestled to frame the City's pension circumstances within the City's disclosure. He was charting new territory. As discussed elsewhere, there are no SEC guidelines for municipal disclosure regarding pension issues or, indeed, any other matters. The closest analog that Mr. Webber found to the City's arrangement with SDCERS was "pension obligation bonds" because, as he told Vinson & Elkins, they convert an obligation to pay actuarially required amounts into an obligation on which one has to pay scheduled debt service. The question that Mr. Webber sought to answer in formulating a disclosure template was how to meaningfully explain to the market all of the factors determining the dimensions and components of the City's annual pension obligations.

Mr. Webber believed that the basic information that should be disclosed was: (1) the City's currently required payment amounts, (2) the amount that the City is paying, per collective bargaining agreements, of its employees' share of their currently required contributions, and (3) the amount of supplemental benefits paid from Plan Assets, thus increasing the UAAL. Other information he thought should be conveyed included methodologies used in calculating UAAL, such as amortization periods, and key assumptions, such as investment returns. Finally, information about responsibility for payment for health care benefits and how they are being funded should, in his view, be disclosed. Mr. Webber viewed the obligation to fund these different benefits as similar to the obligation to pay a debt and, while future debt payments are typically sums certain, and projections regarding the categories described above are not, he believed that "order of magnitude" disclosures could be made to give the prospective investor a general sense of the City's obligations. Mr. Webber believed that the City had a duty to estimate and disclose its anticipated obligations over a reasonable period into the future.

The City staff continued to believe the proposed disclosure was unnecessary and potentially harmful. As the City Treasurer stated to Mr. Webber: "[w]e are in an environment where

---

[358] E-mail from Paul Webber to Ed Ryan, Re: Financial Statements (Nov. 14, 2003).

2. PROPOSED AMENDMENT TO BOARD RULE 10.50 – TERMINATION OF PURCHASE OF SERVICE CONTRACT – **TRAILED TO JULY 2002.**

VIII. REQUESTED ACTION REGARDING THE CITY MANAGER'S REQUEST TO MODIFY THE 1997 MANAGER'S PROPOSAL

Mr. Pierce welcomed Mr. Herring, who is here to address the City Manager's request.

Mr. Herring spoke on behalf of this issue, stating the City Manager had previously come before the Board and outlined his proposal. This proposal is in the context of some labor negotiations that were recently completed with most of the City's employee labor representatives. What he is presenting today are the implications of these negotiations as they relate to the System and its funding trigger. Although these are separate issues, they are tied into the tentative labor agreements.

After reviewing the System's actuary and fiduciary reports, Mr. Herring stated that the Manager's office modified its original proposal on June 18, 2002, in order to mitigate some of the issues that were raised. A copy of the revised proposal was distributed to the Board prior to today's meeting.

He continued by stating that the June 18th memo summarizes those modifications. Irrespective of the funding trigger, it is the Manager's intent to substantially increase the pace by which the employer contributions would occur to reach the full actuarial funding rate, which has been the mutual goal of the Board and City for a number of years. As such, a mechanism was put into place that would actually double the incremental increases that the City would contribute annually, which is more than what was originally outlined and agreed to in the 1997 Manager's Proposal. Therefore, the City would be committing to increase its annual contribution rate by 1% beginning July 1, 2004, versus the .05% originally agreed upon. Additionally, the City would pay the full value of the proposed benefit increase, a blended rate of 1.06%, which the City pays as it goes. With these improvements, Mr. Herring said this is a better proposal than what was agreed to in 1997. The only time the funding ratio would become an important part of this package would be over approximately the next twelve months. Should the funding ratio drop below 75%, the City's contribution rate would increase at 20% per year to reach the full actuarial rate. He referred to the chart attached to the June 18th memo (copies of both are included as "Attachment A" of these minutes). Column "F" reflects the 1% per year increase over and above the base rate. Column "G" reflects the funding ratio should it drop below 75% and the mechanism that would bring it up to 20% per year over a five year period to reach the full actuarial rate. In effect, this new proposal gets the System to full funding at about the same time as the original, even if the trigger isn't triggered. Therefore, he believes this is a better proposal than what was agreed to in 1997. He emphasized that the City's intent to ask the Mayor and Council to embody this in the Municipal Code so it would become law. This would provide certainty that the proposal could not easily be changed. Because the City pays regardless of what the funded ratio is, this is not contingent on the funding ratio. It would also be the City's intent to commit to pay for any other future benefit increases on a pay-as-you-go basis. In addition, the City would meet

with the Board, its actuary and fiduciary counsel to develop a comprehensive, long-term funding approach. With regard to the letter submitted by Attorney Aguirre threatening litigation, he indicated the City receives similar letters from him on almost a weekly basis. In this case, Mr. Aguirre's letter was ripe with misstatements of facts and misapplied assumptions. In looking at the big picture, there is sufficient funding to pay all the bills that the System could incur over the next twenty years, even if no additional contributions were made.

If anyone should have any questions, Mr. Herring stated he and City Auditor, Ed Ryan would remain in the audience to respond.

Mr. Pierce thanked Mr. Herring for his presentation. He asked Mr. Grissom to comment on the context and purview of this Board with regard to this item, which has to do with meet and confer and financing.

MOTION TO APPROVE THE MANAGER'S RECOMMENDED PROPOSAL: **C. LEXIN**

SECOND: **T. WEBSTER**

DISCUSSION:

Mr. Grissom reported that these issues evolved out of the meet and confer process, in which a number of benefit enhancements were agreed upon, but made contingent upon the Board's approval of the Manager's funding proposal. For the benefit of those in the audience, he stated that the Board's approval or disapproval of this proposal is not an approval or disapproval of the enhancements. He reminded the Board that the City confers the benefits and the Board simply administers them. What the City is asking the Board to do is approve is a funding mechanism that would allow these benefit enhancements to be conferred.

Ms. Lexin clarified that even without meet and confer, this issue would be before the Board.

The System's actuary, Mr. Roeder, spoke to the issue (a copy of his presentation materials is included as "Attachment B" of these minutes). He stated that the Board has a fiduciary responsibility to act prudently over the long run. He offered a long-term perspective of what's been happening over the past ten years. In isolation, there is nothing wrong with enhanced benefits, which people tend to favor. There is also nothing wrong with contribution relief—in isolation. However, when enhanced benefits come at the same time as contribution relief, the Board must be cautious. The Manager's Proposal has been in effect for five years, which has allowed the City to pay less than the actuarially assumed rate. The role of a fiduciary must be independent of the setting of existing or potential benefits. He can only urge that in the future, those two functions be truly segregated. As fiduciaries, it is not the Board's duty to involve itself with meet and confer issues. Funding status also needs to be independent of benefit levels. To provide some history, he stated that one of the items in the 1997 Manager's Proposal was to ramp up the rates in hopes of achieving an Entry Age Normal (EAN) rate, which is higher than Projected Unit Credit (PUC), but less volatile. The funded ratio currently is as low as it has ever been, going back to the late 1980's. He illustrated the difference between the City's contribution

Ed Ryan - Incorrect Pension Materials In Bond Solicitation Circular

From: "Diann Shipione Shea" <diann@san.rr.com>
To: "Lawrence Grissom" <LGrissom@sandiego.gov>
Date: 9/5/2003 4:02 PM
Subject: Incorrect Pension Materials In Bond Solicitation Circular
CC: <dick.murphy@sandiego.gov>, "Rick Roeder" <rickro@grsnet.com>, "Fred Pierce" <Fpierce@foundation.sdsu.edu>

September 5, 2003

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

Re: Incorrect Pension Materials in Bond Solicitation Circular

Dear Larry,

It has been brought to my attention from several individuals that information regarding the San Diego City Employees Retirement System is being circulated by the Public Facilities Financing Authority of the City of San Diego regarding the soon to be sold Subordinated Sewer Revenue Bonds. The Pension materials are apparently included in the addendum. These materials appear intentionally dated and substantively incorrect, including, by example, the following:

"The actuary believes the Corridor funding method is an excellent method for the City and that it will be superior to the PUC funding method. The actuary is in the process of requesting the GASB to adopt the Corridor funding method as an approved expending method which would then eliminate any reported NPO."

The independent SDCERS Actuary indicates that these comments are, in fact, dated and taken out of context. He apparently was not asked to opine as to his current thoughts on the "Corridor funding method" which he views in a very different light than that being represented to the purchasers of these securities. Other aspects of the circulated information are likewise incorrect.

From my own reading, the materials do not provide any of the material deficit concerns even at the levels described by our staff.

As a SDCERS Trustee it is my responsibility to bring this to your attention so it can be appropriately addressed so the pension fund will not in anyway be responsible or at risk. Please provide me with written confirmation of such at your earliest convenience.

If you have any questions please contact me at 619-261-3618.

Thank you.

Sincerely,

Diann Shipione
SDCERS Trustee

EXHIBIT # 73

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' maximum safety, integrity and growth.

SDCERS BUSINESS PROCEDURES COMMITTEE MINUTES
FRIDAY, FEBRUARY 16, 2001

The Business Procedures Committee of SDCERS' Retirement Board of Administration held its regularly scheduled meeting in the System's Board Room. Location: 401 "B" Street, Suite 400, San Diego, CA 92101. Ron Saathoff called the meeting to order at 9:30 a.m.

ATTENDANCE:

Committee: Ron Saathoff, Chair; John Casey, Dave Crow, Cathy Lexin, Tom Rhodes, John Torres, Sharon Wilkinson, Terri Webster, Fred Pierce

Staff: Lawrence Grissom, Roxanne Parks, Vincent Hayes, Sally Zumalt, Delia Lencioni, Doug McCalla, Jan Beaton, Monty Perretto, Sheila Leone, Patrick Lane

Public: Conny Jamison, Jeannie Peeples and Mike Wilson of Mercer, Inc., Rick Roeder, Bob Wilson, Stan Elmore, Omar Perez, Dan Kelley, Valerie VanDeweghe and two representatives of Towers Perrin

MINUTES

A. ACTION REQUESTED

1. DISPENSE WITH THE READING AND APPROVAL OF THE MINUTES OF JANUARY 19, 2001

MOTION TO APPROVE THE MINUTES OF JANUARY 19, 2001: D. CROW
SECOND: J. CASEY
COMMITTEE: UNANIMOUS
MOTION TO APPROVE PASSED UNANIMOUSLY.

1. STATUS REPORTS

A. NO ACTION REQUESTED

1. INTRODUCTION OF FY 2000 ACTUARIAL VALUATION

Mr. Roeder distributed a handout.

Mr. Grissom stated that the actuarial valuation lags one year, and these numbers are as of July 1, 2000. He indicated that the impact of the Corbett Lawsuit Settlement was not rolled into this valuation, which is why the valuation looks as impressive as it does. Given the situation, he would recommend the Board direct Mr. Roeder to include those numbers and come

EXHIBIT # 74

back next month. This is especially necessary because of the very complicated Manager's Proposal currently in place.

Mr. Roeder stated he would be happy to include the Corbett impact in this year's valuation, should the Board so direct.

Ms. Wilkinson asked Mr. Grissom for his opinion on how this would change the numbers.

Mr. Pierce asked if including Corbett in this year's valuation would be pushing the envelope.

Mr. Roeder said either approach is acceptable. But candidly speaking, if there had not been such a big actuarial gain last year, GRS would have recommended reflecting Corbett next year. However, this year's gains were so unusual, that with the Manager's Proposal, it would be appropriate to include Corbett this year. Although either approach is acceptable, there is some attractiveness to having more consistency over a three-year period.

Mr. Pierce asked what the numbers would be once Corbett is implemented.

Mr. Roeder replied somewhere between the 11.5% and 12.5% area, depending on how the liabilities are handled.

Mr. Pierce asked about the funded ratio.

Mr. Roeder replied that it would go down to approximately 96% with Corbett liabilities included.

Mr. McCalla said the notes in last year's annual report disclosed the Corbett Settlement payment.

Ms. Webster said it would be prudent to roll the Corbett Settlement into this year's valuation. Otherwise, extreme revenue is reflected without the appropriate liability, which sends a wrong message.

Mr. Saathoff agreed.

Mr. Casey questioned whether this would be long term. If the Board can switch to EAN, which has been the goal, it should do so now and end the Manager's Proposal.

Mr. Saathoff said the Board could include the Corbett rates, but if a switch were made to EAN this year, it would be at about 10%, significantly understating the rates. It is important not to base investment decisions on an anomaly.

Mr. Grissom asked Mr. Roeder what the basis point spread is between PUC (projected unit credit) and EAN (entry age normal).

Mr. Roeder replied that if the Board switches to EAN and includes Corbett, the EAN rate would be between 13% and 14%.

Ms. Jamison agreed with Mr. Casey regarding exploring moving to EAN this year.

Mr. Saathoff asked Mr. Roeder to come back with numbers on PUC including Corbett for retirees after July 1st; EAN this year; and EAN WITH Corbett.

In order to give a clearer picture, Mr. Roeder suggested also recognizing the possibility of including continued benefit payments for retirees that aren't currently valued.

Ms. Wilkinson asked if the retiree Corbett benefit is contingent on a prospective basis?

Mr. Grissom said benefits to those who retire after July 1st are not contingent. Those individuals are going to receive 10% or the factor change

Mr. Saathoff said the retiree class is a closed group.

Mr. Grissom recommended continuing this so he could meet with Mr. Roeder. He suggested that the Board have all contingent benefits valued (versus simply valuing Corbett) along with what the impact would be on the System's investment assumptions.

Mr. Pierce asked about this being based on assumptions. He said there are two generally accepted methods to make the calculation on--PUC and EAN. The Board has clearly stated they would like to switch to EAN in the future because it is less volatile. However, if this switch were made today, the System's funded ratio would be affected.

Mr. Roeder said the rate for EAN would be approximately 8% to 10% more than for PUC.

Mr. Grissom said when the lines crossed the Manager's Proposal would go away, projected to be in 2008. At that time, the Manager's Proposal calls for the switch to EAN.

Mr. Saathoff said this year's rate is 10.22%; the City paid rate is 9.33%, with the 200 basis point bump. He said he would like to see that number along with the funded ratio to determine the most prudent way to get to EAN.

Ms. Webster said the Manager's Proposal was not tied to when the Board switches to EAN. It was simply to go away when those lines crossed.

Mr. Grissom said it would be prudent to get the information from Mr. Roeder with Staff to do the trigger points on the Manager's Proposal while maintaining the Manager's Proposal on a funding rate going forward.

Ms. Lexin asked about paying the potential cost of contingent benefits with earnings. She questioned whether that is saying the contingency has a risk that is not being paid.

By lowering the assumption rate, Mr. Roeder said the fund is given additional revenue.

Ms. Lexin asked what the purpose is in doing this.

Mr. Roeder responded that with enough contingent benefits being paid out over the years, the investment earnings are siphoned off. Since investment assumptions are set, some of the investment money that was to be used to pay existing benefits would be gone. Since this is difficult to explain, Mr. Roeder said he would bring a chart to next month's meeting to better explain his point.

Ms. Jamison said the average is lowered.

Mr. Saathoff asked that Mr. Roeder value Corbett under PUC and EAN and then show the numbers illustrating the contingent benefits.

Mr. Saathoff said lowering the assumption rate has nothing to do with paying those contingent benefits.

Ms. Lexin said there wouldn't really be more; it would simply appear to be more.

Mr. Roeder stated that the Board needs to recognize that these benefits are being paid and that future investment earnings will be siphoned off to pay for them. This is a Board policy issue that he is not in a position to comment on.

Mr. Grissom said contingent benefits are fine, but there is a limit, which has been reached.

Ms. Jamison said it's not prudent for the Board to ignore that there might be a time where these benefits can't be paid. If this happens, the retirees would go to the media and City Council to inform them that there has been a diminishment of benefits. She reminded the Board that the 13th check has been paid for the past 17 to 18 years. Therefore, it is not truly a contingent

benefit and the Board should not ignore this fact. From a practical standpoint, the Board has a responsibility to do everything possible to continue to pay these benefits.

Mr. Saathoff agreed to continue the valuation to next month as long as the Board receives the information prior to that meeting.

Mr. Roeder insured this would happen.

Ms. Wilkinson stated it appears that people aren't staying in DROP the full five-years.

Mr. Roeder said he wouldn't be able to determine this until next year, when there is a full five-year's worth of experience.

Mr. Grissom said the Operations Report reflects 600 people in DROP. Of those, 400 have retired and/or left their money on account.

2. FIDUCIARY COUNSEL'S OPINION REGARDING MERCER'S LETTER REGARDING TAX REPORTING ON DISABILITY AND OTHER BENEFITS

Mr. Saathoff stated fiduciary counsel submitted a letter agreeing with Mr. Blum's opinion on tax reporting for disability and other benefits.

3. REPORT ON GENERAL MEMBER RETIREMENT BOARD REPRESENTATIVE ELECTION

Mr. Saathoff stated the general member election is underway.

John Casey and Tom Rhodes volunteered to assist with the ballot count.

4. REPORT ON STRATEGIC PLANNING

Mr. Saathoff stated Staff's accomplishments were included in the Board packet. He recommended that Staff schedule a half-day workshop to further address this.

5. REPORT FROM MERCER REGARDING SDCERS' HEALTH INSURANCE PROGRAM

Mike Wilson and Jeannie Peeples presented the results of the survey Mercer had conducted. (A copy of their presentation material is included as a part of these minutes)

Ms. Lexin asked what the driving shift is away from capitations.

Mr. Wilson said there is a pendulum shift.

U.S. Securities and Exchange Commission

Municipal Bond Participants: Public Officials and Obligated Persons

Public Officials

Report under Section 21(a) of the Exchange Act

Report of Investigation in the Matter of County of Orange, California as it Relates to the Conduct of the Members of the Board of Supervisors., Exchange Act Release No. 36761 (January 24, 1996).

I. Introduction

The staff of the Division of Enforcement has conducted an investigation into various events in 1993 and 1994 involving material misrepresentations and omissions in connection with the offer and sale of certain municipal securities, including those issued by the County of Orange, California (the "County" or "Orange County"). Six of these municipal offerings by the County collectively raised approximately $1.3 billion and are the subject of this report. These offerings were related to the Orange County investment pools (the "County Pools"),[1] in one or more of the following ways: 1) the proceeds from one of the offerings were reinvested in the County Pools to obtain interest earnings; 2) the funds pledged to repay certain of the securities were invested in the County Pools; 3) the County Pools agreed to repurchase or repay certain of the securities; and/or 4) the County's economic reliance on the County Pools materially affected its ability to repay the securities. The Official Statements for these municipal securities offerings contained material misstatements and omissions concerning the risks relating to, among other things, the County Pools and the financial condition of Orange County, including its ability to repay the securities.

Based upon information obtained during the investigation, the Commission deems it appropriate that it issue this Report of Investigation ("Report") pursuant to Section 21(a) of the Securities Exchange Act of 1934 "Exchange Act") with respect to the conduct of the individual members of the Board of Supervisors of Orange County, California (the "Supervisors" or "Board members") in authorizing the issuance of these municipal securities.[2]

Simultaneous to the issuance of this Report, the Commission has filed and settled a related civil injunctive action against the former County Treasurer-Tax Collector, Robert L. Citron (the "Treasurer"), and the former Assistant Treasurer, Matthew R. Raabe (the "Assistant Treasurer"), pursuant to which they will be

enjoined from future violations of the antifraud provisions of the federal securities laws.[3] The Commission has also instituted and settled a related cease and desist proceeding pursuant to Section 8A of the Securities Act of

1933 ("Securities Act") and Section 21C of the Exchange Act against Orange County, the Orange County Flood Control District and the Board of Supervisors of Orange County pursuant to which they will be ordered to cease and desist from violations of the antifraud provisions.[4] The Commission's investigation is ongoing.

The Commission is issuing this Report to emphasize the responsibilities under the federal securities laws of local government officials who authorize the issuance of municipal securities and related disclosure documents and the critical role such officials play with respect to the representations contained in the Official Statements for those securities.[5]

Public entities that issue securities are primarily liable for the content of their disclosure documents and are subject to proscriptions under the federal securities laws against false and misleading information in their disclosure documents.[6] In addition to the governmental entity issuing municipal securities, public officials of the issuer who have ultimate authority to approve the issuance of securities and related disclosure documents have responsibilities under the federal securities laws as well. In authorizing the issuance of securities and related disclosure documents, a public official may not authorize disclosure that the official knows to be false; nor may a public official authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading. When, for example, a public official has knowledge of facts bringing into question the issuer's ability to repay the securities, it is reckless for that official to approve disclosure to investors without taking steps appropriate under the circumstances to prevent the dissemination of materially false or misleading information regarding those facts. In this matter, such steps could have included becoming familiar with the disclosure documents and questioning the issuer's officials, employees or other agents about the disclosure of those facts.

In this case, the Supervisors approved Official Statements that, among other things, failed to disclose certain material information about Orange County's financial condition that brought into question the County's ability to repay its securities absent significant interest income from the County Pools. The Supervisors were aware of material information concerning Orange County's financial condition; this information called into question the County's ability to repay its securities. Nevertheless, the Supervisors failed to take appropriate steps to assure disclosure of these facts. In light of these circumstances, the Board members did not fulfill their obligations under the antifraud provisions of the federal securities laws in authorizing the issuance of the municipal securities and related disclosure documents.

II. Background

A. The Orange County Board Of Supervisors

The Orange County Board of Supervisors (the "Board") is the body through which the County exercises its powers.[7] Orange County is a body corporate and politic and has the powers specified in the California (the "State") Constitution, State statutes, and such implied powers as are necessary for the execution of the powers expressly granted.[8] The Board consists of five full-time members, each serving a term of four years. The Board has

legislative, financial and police powers.

The Board exercises its financial powers through its general supervision of and control over the financial affairs of the County. The powers of the Board include, among others: 1) examination and audit of the financial accounts and records of all officers having responsibility for County moneys;[9] 2) supervision of the official conduct of all County officers, including the Treasurer, "particularly insofar as the functions and duties . . . relate to the assessing, collecting, safekeeping, management or disbursement of public funds";[10] 3) investment and reinvestment of County funds;[11] 4) fiscal powers, including approving the County's proposed budget and adopting the County's final budget;[12] and 5) contracting for County indebtedness,[13] including the issuance of municipal securities.

Although the Board may delegate certain of these duties to County officers and employees, it is ultimately responsible for the execution of these duties. In 1985, the Board formally delegated its authority to invest County funds to its Treasurer.

B. The Supervisors

1. Thomas F. Riley, age 83, was appointed Supervisor in 1974, elected to the Board two years later, and served continuously through 1994, after which he retired. Riley was the Chairman of the Board in 1994.

2. William G. Steiner, age 58, was appointed Supervisor in 1993, elected in 1994, and is currently a member of the Board. His term expires on December 31, 1998.

3. Roger R. Stanton, age 58, was first elected Supervisor in 1980, and is currently a member of the Board and its Chairman. His term expires on December 31, 1996.

4. Gaddi H. Vasquez, age 40, was appointed to the Board in 1987, elected in 1988, and served continuously until his resignation on September 27, 1995. Prior to his resignation, Vasquez was the Chairman of the Board in 1995.

5. Harriett M. Wieder, age 75, was first elected Supervisor in 1978, was Chairman of the Board in 1993 and a member through 1994.

C. The County Pools And Orange County's Financial Dependence On The Pools

The County Pools were instrumentalities of the County and were not established as legal entities distinct from the County. The County Pools operated as an investment fund managed by Orange County through which the Treasurer invested public funds deposited by various local governments or districts (the "Pool Participants" or the "Participants"). As of December 6, 1994, the County Pools held approximately $7.6 billion in Participant deposits, including County funds.

Under California law, the Board may delegate its authority to invest or to

reinvest County funds to the County Treasurer, who thereafter assumes full responsibility for such transactions and who must make monthly reports of the transactions to the Board.[14] Pursuant to this law, the Board delegated its authority to invest and reinvest County funds to the County Treasurer. Notwithstanding this delegation of authority, the Treasurer was required to seek approval from the Board for various kinds of investments.[15] The investment strategy devised by the County Treasurer was risky and was predicated on the assumption that interest rates would remain low. The strategy involved a high degree of leverage through the use of short-term reverse repurchase agreements and a substantial investment in derivative securities of a longer term (including inverse floaters that are negatively affected by a rise in interest rates). For example, on December 6, 1994, when the County Pools held deposits of approximately $7.6 billion, the book value of the leveraged investment portfolios was $20.6 billion.

Orange County's financial condition was closely tied to the financial condition of the County Pools. The County was heavily dependent on the County Pools as a source of income to balance its discretionary budget. The County's discretionary budget was the portion of the County's total budget over which the Board had authority to determine how funds would be allocated.[16] The discretionary budget was also a source of funds for repayment of the municipal securities that are the subject of this report.

The County's use of interest income as a revenue source to balance its discretionary budget had been increasing since at least fiscal year 1991-92, and increased dramatically for fiscal year 1994-95.[17] This increased use of interest income was due to a decline in revenue from other sources, particularly property taxes.[18] By budgeting increased projected interest revenue, Orange County was able to balance its budget and avoid implementing other fiscal measures.

The County had two sources of funds to invest in the County Pools and earn investment interest: its own liquid assets and the proceeds of its municipal securities offerings. From January 1993 to December 6, 1994, Orange County had invested essentially all of its liquid assets in the County Pools, almost $2.3 billion. In 1993 and 1994, Orange County issued $1 billion in municipal securities for the purpose of reinvesting the proceeds in the County Pools.

In early December 1994, the County announced that the County Pools' $20.6 billion investment portfolio had suffered a loss in market value of approximately $1.5 billion. Following liquidation of the portfolio, the County realized a loss of approximately $600 million of its investment in the County Pools.

The County also suffered a loss of $157 million in estimated and budgeted interest earnings from the County Pools, contributing to a projected deficit for fiscal year 1994-95 of approximately $172 million. On December 6, 1994, the County filed a petition for bankruptcy under Chapter 9 of the United States Bankruptcy Code. As a result of Orange County's economic dependence on the County Pools and their subsequent collapse, the County has not repaid or repurchased approximately $910 million in municipal securities at the time they were to mature by their original terms or were tendered for repurchase.[19]

III. The Supervisors Authorized the Issuance of Municipal Securities in 1994

A. The Municipal Securities Offerings

In 1994, the County conducted the six municipal securities offerings that are the subject of this report. These offerings were directly related to the County Pools in one or more of the following ways: 1) the proceeds from certain offerings were reinvested in the County Pools to obtain interest earnings; 2)

the funds pledged to repay certain of the securities were invested in the County Pools; 3) the County Pools agreed to repurchase or repay certain of the securities; and/or 4) the County's economic reliance on the County Pools materially affected its ability to repay the securities.

The Official Statements for these offerings variously contained material misstatements and omissions of fact regarding:

1) the County Pools, including the County Pools' investment strategy and investment results, and the manipulation of the County Pools' yield, which matters affected the issuer's ability to repay the municipal securities and the County Pools' ability to perform under agreements to repurchase or provide for repayment of the municipal securities; 2) Orange County's financial condition, including its economic reliance on the investment results of the County Pools as a source of funds to repay its obligations on the securities; 3) the tax-exempt status of the offering; 4) an undisclosed cap on the interest rate payable to investors on certain variable rate municipal securities sold in the offerings; and 5) the unauthorized use of an audit report.

1. The Reinvestment Offering

The County conducted one reinvestment offering in 1994, the $600,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 TAXABLE NOTES, issued on July 8, 1994. The purpose of this offering was to raise funds to reinvest in the County Pools for profit. In such transactions, an issuer such as Orange County expects to generate profits by investing at a rate of return that is higher than the rate of interest to be paid to the purchasers in the offering.

The County deposited the proceeds from this Reinvestment Offering into an account pledged to repay the notes. The Official Statement for this Reinvestment Offering disclosed that the County intended to invest the pledged funds in the County Pools and that, if an investment loss occurred, the County would satisfy the deficiency from any other moneys lawfully available for repayment. The lawfully available funds consisted essentially of funds in the discretionary budget.

2. The Tax And Revenue Anticipation Note Offerings

In 1994, the County conducted two separate offerings of tax and revenue anticipation notes ("TRANs"), raising a total of $200 million for the purpose of funding cash flow deficits. These offerings were the $169,000,000

COUNTY OF ORANGE, CALIFORNIA 1994-95 TAX AND REVENUE ANTICIPATION NOTES, SERIES A, issued on July 5, 1994, and the $31,000,000 COUNTY OF ORANGE, CALIFORNIA

1994-95 TAX AND REVENUE ANTICIPATION NOTES, SERIES B, issued on August 11, 1994. TRANs are designed to help local governments cover periodic cash flow deficits that arise because they receive revenues infrequently during the year while their working capital expenses remain constant. Such notes are later repaid with the expected tax and other revenue received.

In the Official Statements for these offerings, the County represented that the money pledged to repay the notes would be deposited in the County Pools. The Official Statements further advised prospective investors that, if Orange County suffered an investment loss and the repayment funds were insufficient to repay the notes, the County would satisfy the deficiency from any other moneys lawfully available for repayment. The lawfully available funds consisted essentially of funds in the discretionary budget.

3. The Teeter Offerings

The County conducted two Teeter offerings in 1994: the $111,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 (TEETER PLAN) TAXABLE NOTES, issued on July 20, 1994; and the $64,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 (TEETER PLAN) TAX-EXEMPT NOTES, issued on August 18, 1994. Separately, the County Pools guaranteed repayment of the Teeter notes pursuant to Standby Note Purchase Agreements. The purpose of the Teeter offerings was to fund the Teeter Plan, which is an alternate method of property tax distribution. Pursuant to this plan, Orange County pays local taxing entities (such as school districts) their share of property taxes based upon levy rather than actual collection. Orange County then retains all property taxes, and the penalties and interest thereon, upon collection.

The Official Statements for the Teeter notes represented that the County planned to invest certain delinquent tax receipts pledged to repay the Teeter Notes in the County Pools. The County Pools also agreed to repurchase the Teeter Notes, through Standby Note Purchase Agreements, which agreements obligated the Treasurer, as fund manager of the County Pools, to purchase the Teeter notes to the extent that there were insufficient funds to repay them. The Official Statements further advised prospective investors that if the repayment funds were insufficient, any deficiency would be satisfied from moneys received under the Standby Note Purchase Agreements and other moneys lawfully available for repayment. The lawfully available funds consisted essentially of funds in the discretionary budget.

4. The Pension Bond Offering

Finally, in September 1994, the County issued taxable Pension Obligation Bonds for the purpose of funding the County's unfunded, but accrued, pension liability. The Pension Bonds were issued on September 28, 1994, in two series: the $209,840,000 COUNTY OF ORANGE, CALIFORNIA TAXABLE PENSION OBLIGATION BONDS SERIES 1994A; and the $110,200,000 COUNTY OF ORANGE, CALIFORNIA TAXABLE PENSION OBLIGATION BONDS

SERIES 1994B. One feature of the Series 1994B bonds was that investors had the right to tender their bonds to a remarketing agent for repurchase. A remarketing agent would attempt to resell the bonds during a seven-day period. If the bonds could not be remarketed, the County Pools, pursuant to a Standby Withdrawal Agreement, stood ready to purchase the tendered securities in an amount up to the County's unrestricted funds in the County Pools, which included funds in the County's discretionary budget.

B. Procedures Regarding Approval Of Municipal Securities Offerings

Final authority to approve each issuance of Orange County municipal securities rested with the Supervisors, pursuant to State law. Short-term financings in which the securities matured in thirteen months or less were submitted to the Supervisors for approval on the Treasurer's recommendation. With respect to debt securities in which the maturities exceeded thirteen months, the County Administrative Officer initiated the recommendation for Board action instead of the Treasurer.

Municipal securities offerings were submitted to the Board for its approval through a document entitled Agenda Item Transmittal, prepared by the Treasurer for short-term note offerings and the County Administrative Officer for long-term bond offerings. The Agenda Item Transmittal typically contained a very brief description of a particular transaction and was sent to the Supervisors three to five business days prior to a Board meeting. For short-term financings, other documents such as a Contract of Purchase, a proposed Board resolution and a draft of a Preliminary Official Statement were also prepared in advance of the Board meeting. These documents were known as "back-up" to the Agenda Item Transmittal.[20]

For the six offerings discussed in this Report, the Board adopted authorizing and sale resolutions. For each offering, the resolution adopted by the Supervisors: 1) authorized the issuance of the notes or bonds in a specified dollar amount; 2) approved the Preliminary Official Statement in the draft form presented; 3) delegated authority to the Treasurer or the Assistant Treasurer (or, in the case of the Pension Obligation Bonds, to the County Administrative Officer) to: execute a "deemed final" certificate pursuant to Exchange Act Rule 15c2-12; cause the blanks in the Preliminary Official Statement to be filled in and finalize the Preliminary Official Statement; and execute the Official Statement and to deliver the same to the underwriter; and 4) approved the Official Statement for the offering with such revisions as the Treasurer or Assistant Treasurer (or, in the case of the Pension Bonds, the County Administrative Officer) determined were necessary to make the Official Statement true and correct in all material respects.

In addition, the County retained financial advisers, bond counsel and underwriters to assist in these municipal securities offerings. The County also retained a national accounting firm to audit the County's financial statements. The Supervisors approved the retention of these professionals. While the Supervisors believed that they could rely on these professionals, the Supervisors never questioned the professionals regarding the disclosure in the Official Statements, despite their knowledge of facts calling into question the County's ability to repay the securities.

In preparation for Board meetings, the Supervisors and/or their executive assistants attended weekly briefings regarding the items on the upcoming

agenda, which might consist of 100 or more items. These briefings generally lasted between one and two hours and were conducted by the County Administrative Officer and/or his staff. Prior to the briefing, the County Administrative Officer reviewed each agenda item, including those concerning the securities offerings, and typically concurred with the recommendations made by the Treasurer. The County Administrative Officer's review was principally focused on ensuring that the agenda item was consistent with both the adopted budget and the Board's policies.

The Supervisors' executive assistants reviewed the Agenda Item Transmittals and occasionally the back-up documentation. The level of review performed by an executive assistant varied considerably, ranging from mere receipt of the Agenda Item Transmittal to reviewing and summarizing both the Agenda Item Transmittal and back-up documentation, when such documentation was available.

The level of review performed by each Supervisor varied. For example, some of the Supervisors reviewed the Agenda Item Transmittal and summaries of the Agenda Item Transmittal back-up documentation; however, no Supervisor recalled reading any of the draft Preliminary Official Statements or related documents. At least one Supervisor did not review any written documentation and instead relied on the County Administrative Officer and his staff and that Supervisor's executive assistant for advice on how to vote.

Each of the six offerings was placed on the Board's "consent calendar" which contained the vast majority of the agenda items. Each of the subject offerings was approved by consent.

IV. The Supervisors failed to take steps to assure that the County's financial condition was disclosed when they authorized the issuance of Municipal Securities in 1994

Through the formulation and adoption of the County budget, the Supervisors were aware of the County's increasing use of interest earnings from County funds invested in the County Pools as a source of revenue to balance the discretionary portion of the County's budget.

In connection with the budget approval process in fiscal years 1993-94 and 1994-95, the Supervisors were copied on reports from the County Auditor-Controller (the "County Auditor") to the County Administrative Officer discussing the availability of discretionary funds. These documents reported that interest income was a significant factor in balancing the discretionary budget, particularly in 1994.[21]

The first report in 1994 was distributed in February, and referred to the County's use of interest earnings to offset decreases in other revenue sources. Similarly, the May 1994 County Auditor's report cautioned that the projected budget included interest earnings that were "significant," and that the County could not rely on that source "for the long term." The report further stated that interest earnings had "become an increasingly important source of revenue" and were subject to a variety of factors that may cause such revenue to fluctuate significantly." The May County Auditor's report concluded by advising that "prudent management of one-time revenues

[e.g., certain kinds of interest income] is critical to our investment policies and bond rating."

In the August 1994 County Auditor's report, which was copied to the Supervisors prior to the Pension Bond Offering, the County Auditor asserted that "we should be concerned that interest income . . . [is] financing a significant portion of the budget. The [fiscal year] 1995 interest income projection represents 35 percent of the available financing and is our single largest source of discretionary revenue." Further, the report advised that "[i]nterest income is projected based on increased earnings due to increased taxable and nontaxable borrowings," making clear that, in order to balance the budget, the County was issuing an increasing number of municipal securities offerings in order to obtain increased interest earnings on the investment of such funds.[22]

Despite the use of investment income to balance the County's discretionary budget, the Supervisors testified that they did not understand the investment strategy, the risks of that strategy or the potential risk of loss to the County Pools' principal.[23] However, the Board was provided with certain information regarding the County Pools. This information consisted of the Treasurer's annual financial statements, which statements discussed in general terms the County Pools, including the investment strategy and results. For example, in the September 1993 annual financial statement addressed to, and received by the Board, the Treasurer reported to the Supervisors that the County Pools' strategy involved the use of leverage of approximately 2 to 1 and structured or floating rate securities, and was predicated on interest rates remaining low over the next three years. The Treasurer further advised that the County's investment returns were higher than other local investment pools because of the use of reverse repurchase agreements which added an additional two and one-half percent to the yield. Additionally, the Treasurer also stated that it was his investment policy to hold all securities purchased to maturity, that it was his opinion that interest rates could not be sustained at a high rate and that it was also his opinion that there was no risk of principal loss. In September 1994, the Treasurer reported to the Board that he continued to use reverse repurchase agreements which added an additional two percent yield to the portfolio.

The Treasurer had in prior years submitted to the Board monthly reports of investment transactions, as required by California law; however, he ceased submitting such reports in 1991. The Board took no steps to require the Treasurer to comply with State law and produce the reports.

As a result, the Supervisors failed to have sufficient information concerning the investment of County funds and the impact of the investment of those funds on the financial condition of the County and its ability to repay investors in Orange County's municipal securities.

When the Supervisors approved the 1994 offerings of municipal securities discussed above, they were well aware of the increasing budgetary pressure caused by the declining availability of property tax revenues and other discretionary revenues. Indeed, at least one of the offerings was conducted for the sole purpose of providing additional income to the County. Moreover, the Supervisors were informed that interest projections were based on increased amounts of borrowing.

Despite their knowledge of the County's increasing use of interest income from the County Pools to balance the discretionary budget, the Supervisors approved the Official Statements for the various offerings without taking steps to assure disclosure of this information. They never received or asked to receive a copy of any Preliminary Official Statement once finalized, or any final Official Statement; nor did they question the County's officials, employees or other agents concerning the disclosure regarding the County's financial condition. Thereafter, the Supervisors chose to authorize and approve approximately $1.3 billion of municipal securities offerings.

V. Conclusion

In addition to the responsibilities imposed on issuers of municipal securities, the antifraud provisions of the federal securities laws impose responsibilities on a public official who authorizes the offer and sale of securities. A public official who approves the issuance of securities and related disclosure documents may not authorize disclosure that the public official knows to be materially false or misleading; nor may the public official authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading. When, for example, a public official has knowledge of facts bringing into question the issuer's ability to repay the securities, it is reckless for that official to approve disclosure to investors without taking steps appropriate under the circumstances to prevent the dissemination of materially false or misleading information regarding those facts. In this matter, such steps could have included becoming familiar with the disclosure documents and questioning the issuer's officials, employees or other agents about the disclosure of those facts.

The Supervisors were aware of the financial condition of the County and that interest income from the County Pools had become a major component of the County's discretionary budget in an environment of increasing budgetary pressure. The Supervisors also knew that the increase in such interest income was connected to the increased amount of County municipal securities offerings and approved at least one offering conducted solely to raise funds for reinvestment. Based on the Supervisors' significant knowledge relating to the County's finances, they should have understood the materiality of that information to the County's ability to repay the municipal securities. The Supervisors therefore had a duty to take steps appropriate under the circumstances to assure accurate disclosure was made to investors regarding this material information. The Supervisors, however, failed to take appropriate steps. For example, while the Supervisors believed that they could rely on the County's officials, employees or other agents with respect to these offerings, they never questioned these officials, employees or other agents regarding the disclosure of this information; nor did they become familiar with the disclosure regarding the County's financial condition. Had they taken such or similar steps, it should have been apparent to each Supervisor, in light of his or her knowledge, that the disclosure regarding the County's financial condition may have been materially false or misleading.

Consequently, the Supervisors failed to assure appropriate disclosure of these matters by authorizing and approving the dissemination of misleading disclosure documents. This failure denied investors the fair and accurate disclosure required under the federal securities laws.

By the Commission.

Footnotes

-[1]-As discussed below, the County Pools were instrumentalities of the County and were not established as legal entities distinct from the County. The County Pools operated as an investment fund managed by Orange County in which the County and various local governments or districts invested or deposited public funds.

-[2]-Section 21(a) of the Exchange Act authorizes the Commission, in its discretion, to publish information "concerning any . . . violations" and to investigate "any facts, conditions, practices or matters which it may seem necessary or proper" in fulfilling its responsibilities under the Exchange Act. This does not constitute an adjudication of any fact or issue addressed herein. The Supervisors have consented to the issuance of this Report without admitting or denying any of the statements or conclusions set forth herein.

-[3]-See Securities and Exchange Commission v. Robert L. Citron and Matthew R. Raabe, Civil Action No. (C.D. Cal.).

-[4]-In the Matter of County of Orange, California; Orange County Flood Control District; and County of Orange, California Board of Supervisors, Exchange Act Release No. _____ (January ___, 1996).

-[5]-The Commission has previously reviewed disclosure practices of issuers and others in connection with offerings of municipal securities. See Staff of the Securities and Exchange Commission, Staff Report on Transactions in Securities of the City of New York, Transmitted to subcommittee on Economic Stabilization of the Committee on Banking, Finance and Urban Affairs, House of Representatives, 95th Cong., 1st Sess. (Comm. Print 1977); Final Report in the Matter of Transactions in the Securities of the City of New York, Exchange Act Release No. 15,547, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) 81,936 (Feb. 5, 1979); Staff Report on the Investigation in the Matter of Transactions in Washington Public Power Supply System Securities, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) 84,327 (1988); Proposal of Exchange Act Rule 15c2-12, Exchange Act Release No. 26,100, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) 84,326 (Sept. 22, 1988); Adoption of Exchange Act Rule 15c2-12, Exchange Act Release No. 26,985, 4 Fed. Sec. L. Rep. (CCH) 25,098 (June 28, 1989) (the "1989 Release"); Division of Market Regulation, Securities and Exchange Commission, Staff Report on the Municipal Securities Market (Sept. 1993); Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and Others, Securities Act Release No. 7049 and Exchange Act Release No. 33,741, 7 Fed. Sec. L. Rep. (CCH) 72,442 (March 9, 1994) (the "March 1994 Release"); Proposal of Amendments to Exchange Act Rule 15c2-12, Exchange Act Release No. 33,742, [1993-1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) 85,324 (March 9, 1994); Adoption of Amendments to Exchange Act Rule 15c2-12, Exchange Act Release No. 34,961, [1994-1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) 85,456 (Nov. 10, 1994).

-[6]- See March 1994 Release; 1989 Release, supra note 5, at 18,199-10 and n.84; see also In re Citisource, Inc. Securities Litigation, 694 F. Supp.

1069, 1072-75 (S.D.N.Y. 1988); Draney v. Wilson, Morton, Assaf & McElligot, 597 F. Supp. 528, 531 (D. Ariz. 1983).

-[7]-See Board of Supervisors of Modoc County v. Archer, 18 Cal. App. 3d 717, 721, 96 Cal. Rptr. 379, 382 (1971); Cal. Gov't Code § 23005 (West 1988).

-[8]- Cal. Const. Art XI, § 1 (West Supp. 1995); Cal. Gov't Code § 23003 (West 1988).

-[9]-Cal. Gov't Code § 25250 (West 1988).

-[10]-Cal. Gov't Code § 25303 (West 1988).

-[11]-Cal. Gov't Code § 53601 (West Supp. 1995).

-[12]-Cal. Gov't Code §§ 29000-29093 (West 1988 & Supp. 1995).

-[13]-Cal. Gov't Code § 25256 (West 1988).

-[14]-See Cal. Gov't Code §§ 53601, 53607 and 53608 (West 1983 & Supp. 1995). See also Cal. Gov't Code § 25303 (West 1988) ("board of supervisors shall supervise the official conduct of all county officers, . . . particularly insofar as the functions and duties . . . relate to the assessing, collecting, safekeeping, management, or disbursement of public funds").

-[15]-For example, at the Treasurer's request in 1985, the Board authorized the Treasurer to engage in reverse repurchase agreements. Additionally, in 1993, the Treasurer sought and received Board authorization to invest in securities with maturities exceeding five years.

-[16]-For fiscal year 1994-95, Orange County's total budget was approximately $3.7 billion. Of that amount, the County was required to spend about 88%, or $3.266 billion, for specific purposes. The remaining 12%, or $462.5 million, comprised Orange County's discretionary budget. The largest portion of the $462.5 million discretionary budget, $162 million, or 35%, was budgeted to come from investment income on Orange County's investment in the County Pools.

-[17]-For fiscal year 1991-92, interest earnings were $36.8 million, or 7.4% of the discretionary budget; for fiscal year 1992-93, $64.5 million, or 12.4% of the discretionary budget; and for fiscal year 1993-94, they were budgeted at $58.3 million, or 15.1% of the discretionary budget.

-[18]-Property tax revenues comprised 52.8% of the total discretionary budget for fiscal year 1991-92, 49.1% for fiscal year 1992-93, 33.4% for fiscal year 1993-94, and were projected to be only 25.4% for fiscal year 1994-95.

-[19]-These municipal securities have been rated in default by one rating agency. In Orange County's bankruptcy proceeding, the County, the noteholders and the creditors' committee agreed to extend, or rollover, the maturity of approximately $800 million of these municipal securities to June 30, 1996.

-[20]-The back-up documentation was not always submitted with the Agenda Item Transmittal. In some instances, the back-up documentation was only filed the day before the Board meeting, or was not distributed to the Supervisors' offices but only to the Clerk of the Board. For example, for two offerings in 1994, the draft Preliminary Official Statements were not filed with the Clerk of the Board until the day before the meeting. For a third offering in 1994, the draft Preliminary Official Statement was filed with the Clerk of the Board on the Friday before the meeting scheduled for Tuesday.

-[21]- In the 1993 County Auditor's reports, the County Auditor stated that one-time revenues, such as certain types of interest earnings, were increasingly being used to balance the County budget and that it was "not fiscally responsible to continue budgeting in this manner any longer."

-[22]-The six offerings, raising a total of approximately $1.3 billion, were authorized by the Supervisors during a three-month period in 1994 --the same three months during which the Supervisors were also in the process of adopting the County's final budget. Further, the municipal securities issued in all but one of the offerings matured one year from the date of their issuance, thereby increasing the significance of the County's current financial condition as it related to the County's ability to repay the securities.

-[23]-During the course of the Treasurer's re-election campaign in the Spring of 1994, the Treasurer's investment strategy was criticized by his opponent as too risky for public funds. The Supervisors were aware of the criticism. The public criticism, however, did not prompt any inquiry or review by the Supervisors.

To Contents

Injunctive Proceedings

Securities and Exchange Commission v. Larry K. O'Dell, Civ. Action No. 98-948-CIV-ORL-18A (M.D. Fla.); Litigation Release No. 15858 (August 24, 1998) (settled final order).

The Securities and Exchange Commission today announced the filing of a Complaint against Larry K. O'Dell, the former Director of Public Works for Osceola County, Florida, for failing to disclose his receipt of bribes for assisting a brokerage firm in its selection to sell County bonds.

The Complaint, filed in the Middle District of Florida, alleges the following: In 1992, while the Director of Public Works, O'Dell entered into a secret arrangement with a consultant working for a brokerage firm. The arrangement provided that, in exchange for O'Dell's assistance with the brokerage firm's selection as one of the firms to sell the $149,999,313 Osceola Parkway Project bonds (dated July 15, 1992), the consultant would share his compensation from the firm with O'Dell. After entering into the arrangement, O'Dell persuaded the Osceola County Manager to put the firm in the selling group for the bonds, without disclosing his economic interest in the matter to the County Manager. Following closing of the bond offering,

the consultant gave O'Dell money and other things of value totaling $1,755.82. Neither the arrangement nor the benefits conferred thereunder were disclosed to the issuer of, or investors in, the bonds. O'Dell's failure to disclose the arrangement, the payments, and the actual and potential conflicts of interest created thereby, violated the following antifraud provisions of the federal securities laws: Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder.

Simultaneously with the filing of the Complaint, and without admitting or denying the allegations contained in the Complaint, O'Dell agreed to the entry of a final judgment permanently enjoining him from future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; and ordering him to pay (1) disgorgement to Osceola County totaling $2,649.57, consisting of the $1,755.82 O'Dell received pursuant to the undisclosed arrangement, plus prejudgment interest thereon, and (2) a civil penalty of $5,000.

Also today, the United States Attorney for the Middle District of Florida filed a criminal plea agreement with O'Dell, pursuant to which O'Dell has agreed to plead guilty to a single felony count of bribery in violation of 18 U.S.C. § 666, arising from the conduct that is the subject of the Commission's Complaint.

The Commission's investigation concerning pay-to-play practices in Florida continues.

To Contents

SEC v. Robert L. Citron and Matthew R. Raabe, Civ. Action No. SACV 96-74 GLT (C.D. Cal.), Litigation Release No. 14792 (January 24, 1996) (complaint).

The United States Securities and Exchange Commission announced that on January 24, 1996, the Commission brought its first enforcement actions relating to the Commission's investigation into the financial collapse of Orange County, California and the Orange County Investment Pools (the "County Pools"). Specifically, the enforcement actions taken by the Commission today are:

- the filing of a complaint in the United States District Court against former Orange County Treasurer-Tax Collector Robert L. "Bob" Citron and former Assistant Treasurer Matthew R. Raabe

- the institution of a cease and desist administrative proceeding and the entry of a cease and desist order against Orange County, the Orange County Flood Control District and the Orange County Board of Supervisors

All of the above parties were charged with violations of the antifraud provisions of the federal securities laws, Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Citron and Raabe, without admitting or denying the

allegations in the complaint, consented to the entry of final judgments of permanent injunction, enjoining them from future violations of the antifraud provisions. Orange County, the Flood Control District and the Board of Supervisors submitted an Offer of Settlement, in which, without admitting or denying the findings, they consented to the entry of an Order which makes findings and orders them to cease and desist from committing or causing any violation and any future violation of the antifraud provisions. In addition, all of the parties agreed to cooperate with the Commission staff in the continuing investigation and any resulting litigation.

Also on January 24, the Commission issued a Report of Investigation concerning the conduct of individual members of the Board of Supervisors, namely, Thomas F. Riley, William G. Steiner, Roger R. Stanton, Gaddi H. Vasquez and Harriett M. Wieder. The Report of Investigation does not constitute an adjudication of any fact or issue addressed in the Report. The Supervisors have consented to the issuance of the Report without admitting or denying any of the statements or conclusions addressed therein. The enforcement proceedings concern the fraudulent offer and sale of over $2.1 billion in municipal securities issued in 1993 and 1994 by Orange County, the Flood Control District and a school district located within Orange County, which was not named in the actions. Raabe, acting in his capacity as a County employee, was principally responsible for the two offerings by the school district.

THE MUNICIPAL SECURITIES OFFERINGS

The following eleven municipal securities offerings are the subject of the enforcement actions taken today:

- the $400,000,000 COUNTY OF ORANGE, CALIFORNIA 1993-94 TAXABLE NOTES issued on July 1, 1993 ("Reinvestment Notes")
- the $600,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 TAXABLE NOTES issued on July 8, 1994 ("Reinvestment Notes")
- the $299,660,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 POOLED TAX AND REVENUE ANTICIPATION NOTES, issued on July 1, 1994 ("TRANs")
- the $169,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 TAX AND REVENUE ANTICIPATION NOTES, SERIES A issued on July 5, 1994 ("TRANs")
- the $31,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 TAX AND REVENUE ANTICIPATION NOTES, SERIES B issued on August 11, 1994 ("TRANs")
- the $111,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 (TEETER PLAN) TAXABLE NOTES issued on July 20, 1994 ("Teeter Notes")
- the $64,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 (TEETER PLAN) TAX-EXEMPT NOTES issued on August 18, 1994 ("Teeter Notes"),

- the $209,840,000 COUNTY OF ORANGE, CALIFORNIA TAXABLE PENSION OBLIGATION BONDS SERIES 1994A and the $110,200,000 COUNTY OF ORANGE, CALIFORNIA TAXABLE PENSION OBLIGATION BONDS SERIES 1994B both issued on September 28, 1994 ("Pension Bonds")

- the $100,000,000 ORANGE COUNTY FLOOD CONTROL DISTRICT TAXABLE NOTES issued on August 2, 1994 ("Reinvestment Notes")

- the PLACENTIA-YORBA LINDA UNIFIED SCHOOL DISTRICT $50,000,000 TAXABLE NOTES issued on August 26, 1993 ("Reinvestment Notes")

- the PLACENTIA-YORBA LINDA UNIFIED SCHOOL DISTRICT $50,000,000 TAXABLE NOTES issued on August 1, 1994 ("Reinvestment Notes")

The County Pools and their relation to the Municipal Securities offerings

Each of the municipal securities offerings was significantly dependent upon the County Pools such that accurate disclosure about the County Pools was material to investors. The County Pools operated as an investment fund managed by Orange County in which the County and various local governments or districts invested or deposited public funds. The County Pools consisted of the Commingled Pool, the Bond Pool and Specific Investments. Each of the municipal securities offerings was connected to the County Pools in one or more ways:

- the proceeds from certain offerings were reinvested in the County Pools to obtain interest earnings;

- the funds pledged to repay certain of the securities were invested in the County Pools;

- the County Pools agreed to repurchase or repay certain of the securities; and/or

- the County's economic reliance on the County Pools materially affected its ability to repay the securities.

Misstatements and omissions alleged in the Commission's Actions

As set forth below, the County, the Flood Control District, the Board of Supervisors, Citron and Raabe variously made material misstatements and omissions of fact in the Official Statements for the eleven offerings, regarding:

- the County Pools, including the County Pools' investment strategy and investment results, manipulation of the County Pools' yield and investment in the County Pools of the funds pledged to repay the municipal securities. These matters affected the issuer's ability to repay the securities and the County Pools' ability to perform under agreements to repurchase or provide for repayment of the securities;

- Orange County's financial condition, including its economic reliance on interest income from the County Pools as a source of funds to repay the purchasers of the securities;
- the tax-exempt status of the offering;
- an undisclosed interest rate cap on certain variable rate securities sold in the offerings; and
- the unauthorized use of an audit report prepared by an outside accounting firm.

In addition, in connection with the offer and sale of certain of the securities, misrepresentations were made to national securities rating agencies concerning the County Pools.

Misstatements and Omissions Regarding the County Pools

The Official Statements for the eleven offerings misrepresented or omitted to disclose material information concerning the County Pools, despite their significance to each of the offerings. Where the funds pledged to repay the noteholders were invested in the County Pools, the issuer looked to that investment to satisfy its repayment obligations. Any risks that those pledged funds would decrease affected the issuer's ability to repay the noteholders. Similarly, in the offerings where the County Pools agreed to repurchase the securities, disclosure regarding the County Pools was important so that investors could evaluate the County Pools' financial strength and ability to perform under the agreement. In addition, in certain Orange County offerings in which other County funds were a source of repayment, disclosure regarding the County Pools was important to investors because availability of such other funds depended upon the County Pools' performance.

Citron and Raabe caused the County Pools to engage in a very risky investment strategy. The strategy involved using a high degree of leverage by obtaining funds through reverse repurchase agreements on a short-term basis (less than 180 days), and investing in securities with a longer maturity (generally two to five years), many of which were volatile derivative securities.

The County Pools' investment return was to result principally from the interest received on the securities in the County Pools. Leverage enabled the County Pools to purchase more securities for the purpose of generating increased interest income. This strategy was profitable as long as the County Pools were able to maintain a positive spread between the long-term interest rate received on the securities and the short-term interest rate paid on the funds obtained through reverse repurchase agreements.

The Official Statements variously contained false or misleading disclosure regarding the County Pools in four areas:

1. Investment Strategy and the Risks of That Strategy

The Official Statements for all eleven offerings misrepresented and/or failed

to disclose material information concerning the County Pools' investment strategy and the risks of that strategy. With respect to the investment strategy, the Official Statements failed adequately to disclose that the strategy: 1) was risky; 2) was predicated upon the assumption that prevailing interest rates would remain at relatively low levels; 3) involved a high degree of leverage through the use of reverse repurchase agreements; 4) involved a substantial investment in derivative securities, including inverse floaters that are negatively affected by a rise in interest rates; and 5) was very sensitive to changes in the prevailing interest rate because of the leverage.

During 1993 and 1994, Citron and Raabe leveraged the County Pools to amounts ranging from 158% to over 292%. Moreover, volatile derivative securities comprised from 27.6% to 42.2% of the combined County Pools' portfolio and from 31% to 53% of the Commingled Pool's portfolio. From January 1993 through November 1994, from 24.89% to 39.84% of the County Pools' total portfolio consisted of inverse floaters. In contrast, the County Pools invested only sparingly in securities that paid interest rates directly related to the prevailing interest rate (variable rate securities) or securities that paid interest rates that rose at certain stated intervals to certain stated rates (step-up securities). From January 1993 through November 1994, only 1.84% to 5.59% of the County Pools' portfolio consisted of such securities. Accordingly, the County Pools invested in inverse floaters to speculate on the direction of short and long-term interest rates.

The Official Statements also failed to adequately disclose the risks of the investment strategy. Specifically, if interest rates rose, as they did in 1994, it would have a substantial negative impact on the County Pools and, because of its dependence on the County Pools, the County itself.

First, the reverse repurchase costs would increase and the income that the County Pools earned from the inverse floaters in the portfolio would decrease, creating lower earnings for the County Pools. Second, the County Pools' securities would decline in market value. Third, as the value of the County Pools' securities fell, the County would suffer collateral calls from broker-dealers and reductions in loan amounts on the reverse repurchase agreements. All three events would reduce the income that Orange County would receive from the County Pools, with the possible loss of principal of invested funds as well. None of these risks were disclosed.

2. Investment Results

The Official Statements for the nine offerings conducted in 1994 failed to disclose material information concerning the County Pools' investment results. During 1994, the County Pools' investment income declined because reverse repurchase costs had increased while the income that the County Pools earned from inverse floaters had decreased. Additionally, the County Pools had suffered substantial market losses in the overall value of the portfolio. The declining market value of securities in the County Pools resulted in collateral calls and reductions in amounts obtained under reverse repurchase agreements and liquidity. These results were not disclosed to investors in the 1994 offerings.

3. Manipulation of the Yield

The Official Statements for eight offerings--the three 1994 Reinvestment Notes, the $169 Million and the $31 Million TRANs, the two Teeter Notes and the Pension Bonds--misrepresented that the County Pools' yield would be distributed pro rata to the Participants. Citron and Raabe had in fact diverted interest income from certain Commingled Pool Participants to an account for the benefit of Orange County. As a result, the Commingled Pools' yield was misrepresented in the Official Statements for these offerings. In late 1994, Citron and Raabe used a portion of the misappropriated funds to supplement the Commingled Pools' yield. The "supplemented" yield was then falsely reported in the Official Statement for the Pension Bonds.

Citron and Raabe also shifted market losses from some Specific Investment Participants, including the County, to the Commingled Pool, causing the Commingled Pool Participants to suffer losses that should have been borne by others. This information was not disclosed and also rendered false the representations regarding the pro rata distribution.

4. Investment in the County Pools

The Official Statements for the $400 Million Reinvestment Notes, the 1993 $50 Million Reinvestment Notes and the $299.66 Million Pooled TRANs stated that the funds pledged to repay the Notes would be invested as permitted by the resolutions authorizing the issuance and sale of the Notes and by California law. None of the Official Statements for these three offerings disclosed that the issuer intended to invest such funds in the County Pools. In fact, there is no narrative discussion of the Pools in the Official Statements for the two reinvestment offerings.

Misstatements and Omissions Regarding the Financial Condition of the County

The Official Statements for six of Orange County's offerings failed to disclose Orange County's true financial condition, in particular, that the County was using interest income from the County Pools as the largest single source of revenue for its discretionary budget. These offerings are the $600 Million Reinvestment Notes, the $169 Million and $31 Million TRANs, the two Teeter Notes and the Pension Bonds. Further, the County's use of this interest income as a revenue source was increasing while other traditional revenue sources, such as property taxes, were decreasing. The funds invested to generate investment income came from two sources, the County's own funds and proceeds from the reinvestment offerings. Orange County had invested essentially all of its liquid assets in the County Pools, including funds to repay its municipal securities. In addition, the investment of virtually all of the County's liquid assets in the County Pools exposed Orange County to the volatility of the County Pools, including the potential loss of not only interest income, but of principal as well. The failure to disclose this information rendered disclosure regarding the County's financial condition and its ability to repay its securities materially misleading.

This information regarding Orange County's financial condition was important as it related to Orange County's ability to repay its obligations, including the municipal securities debt. Moreover, with the exception of the Pension Bonds, these County offerings were short-term general obligations,

which, under California law, the County could repay only with funds received or accrued during fiscal year 1994-95. Therefore, given the County's use of interest income from the County Pools, if the County Pools' investments performed poorly, as eventually occurred, the County would have a budget deficit and could not repay the securities and meet its other expenses. The County's financial condition was also material to the County's ability to perform under certain agreements to repurchase or provide for repayment of the securities.

Misstatements and Omissions Regarding the Tax-Exempt Status of the Offering

The Official Statements for the $169 Million and $31 Million TRANs represented that these securities offerings were tax-exempt. These TRAN offerings were to fund the County's cash flow deficit. In order to qualify for tax-exempt status, the offerings must comply with certain IRS regulations that limit the amount that may be raised through tax-exempt offerings. With respect to both of these offerings, the County jeopardized the tax-exempt status of these offerings by increasing the size of its cash flow deficit, and, thereby, the size of the offering, through artificial means. None of the facts relating to the County's artificial increase of the size of its cash flow deficit were disclosed in the Official Statements for these offerings.

Misstatements and Omissions Regarding an Undisclosed Cap on the Interest Rate Payable to Investors

The Official Statements for the $600 Million Reinvestment Notes, the $111 Million Teeter Notes and the $100 Million Reinvestment Notes each stated that they paid a variable interest rate connected to the one-month LIBOR. Undisclosed, however, was the fact that the Notes for each of these offerings contained a 12% cap on the maximum variable interest rate that would be paid by the County. While the existence of this cap was indicated on the face of the Notes, no disclosure was made to noteholders prior to purchase.

Misstatements and Omissions Regarding the Unauthorized Use of an Audit Report

The Official Statements for seven offerings falsely represented that the County's auditor "consented to the inclusion . . . of the County's audited financial statements. . ., together with the report accompanying the audited financial statements." The offerings which contained the false statement were the $600 Million Reinvestment Notes, the $400 Million Reinvestment Notes, the two Teeter Notes, the $169 Million TRANs, the $31 Million TRANs and the $100 Million Reinvestment Notes. This report and Orange County's audited financial statements were included as exhibits to the Official Statements for these offerings.

In fact, the auditors did not consent to the inclusion of their report, did not conduct any post-audit review and were not even aware that the Official Statements represented that they consented to the inclusion of the report until after the County filed for bankruptcy.

Misrepresentations to Rating Agencies

In presentations to national rating agencies relating to eight offerings--the $600 Million, the $100 Million and the 1994 $50 Million Reinvestment Notes, the $169 Million and the $31 Million TRANs, the two Teeter Notes and the Pension Bonds--Raabe misrepresented the County Pools' holdings. These misrepresentations ultimately ran to the purchasers of these securities. Raabe represented that only 20% of the County Pools' portfolio consisted of derivative securities. In fact, derivative securities comprised from 27.6% to 42.2% of the combined County Pools' portfolio and from 31% to 53% of the Commingled Pool's portfolio. In particular, inverse floaters comprised from 24.89% to 39.84% of the County Pools' holdings.

Raabe also misrepresented to rating agencies that money in an Orange County account designated the "Economic Uncertainty Fund" was available to pay the principal and interest on five offerings--the $600 Million Reinvestment Notes, the $169 Million and the $31 Million TRANs and the two Teeter Notes--and omitted to disclose that such funds had been misappropriated from the Commingled Pool Participants.

Report of Investigation Issued concerning Individual Members of the Board of Supervisors

Additionally, the Commission issued a Report of Investigation pursuant to Section 21(a) of the Exchange Act with respect to the conduct of the individual members of the Board of Supervisors in authorizing six of the Orange County offerings. The individual members of the Board of Supervisors have consented to the issuance of the Report, without admitting or denying any of the statements or conclusions contained in the Report.

In 1993 and 1994, the individual members of the Board included:

- Thomas F. Riley, age 83, who was appointed Supervisor in 1974, elected to the Board two years later, and served continuously through 1994, after which he retired. Riley was the Chairman of the Board in 1994.

- William G. Steiner, age 58, who was appointed Supervisor in 1993, elected in 1994, and is currently a member of the Board. His term expires on December 31, 1998.

- Roger R. Stanton, age 58, who was first elected Supervisor in 1980, and is currently a member of the Board and its Chairman. His term expires on December 31, 1996.

- Gaddi H. Vasquez, age 40, who was appointed to the Board in 1987, elected in 1988, and served continuously until his resignation on September 27, 1995. Prior to his resignation, Vasquez was the Chairman of the Board in 1995.

- Harriett M. Wieder, age 75, who was first elected Supervisor in 1978, was Chairman of the Board in 1993 and a member through 1994.

The Commission is issuing this Report to emphasize the responsibilities under the federal securities laws of local government officials who authorize

the issuance of municipal securities and related disclosure documents and the critical role such officials play with respect to the representations contained in the Official Statements for those securities.

In authorizing the issuance of securities and related disclosure documents, a public official may not authorize disclosure that the official knows to be false; nor may a public official authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading. When, for example, a public official has knowledge of facts bringing into question the issuer's ability to repay the securities, it is reckless for that official to approve disclosure to investors without taking steps appropriate under the circumstances to prevent the dissemination of materially false or misleading information regarding those facts. In this matter, such steps could have included becoming familiar with the disclosure documents and questioning the issuer's officials, employees or other agents about the disclosure of those facts.

In this case, the Supervisors approved Official Statements that, among other things, failed to disclose certain material information about Orange County's financial condition that brought into question the County's ability to repay its securities absent significant interest income from the County Pools. The Supervisors were aware of material information concerning Orange County's financial condition; this information called into question the County's ability to repay its securities. Nevertheless, the Supervisors failed to take appropriate steps to assure disclosure of these facts. In light of these circumstances, the Board members did not fulfill their obligations under the antifraud provisions of the federal securities laws in authorizing the issuance of the municipal securities and related disclosure documents.

The Commission's investigation remains ongoing.

To Contents

SEC v. Robert L. Citron and Matthew R. Raabe, Litigation Release No. 14913 (May 17, 1996) (settled final orders).

The United States Securities and Exchange Commission announced that on May 9, 1996, the Honorable Gary L. Taylor, United States District Court for the Central District of California, entered final judgments of permanent injunction against Robert L. Citron and Matthew R. Raabe. In its Complaint filed January 24, 1996, the Commission charged former Orange County Treasurer-Tax Collector Robert L. Citron and former Assistant Treasurer Matthew R. Raabe with violations of the antifraud provisions of the federal securities laws, Section 17(a) of the Securities Act of 1933 and Section 10 (b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Citron and Raabe, without admitting or denying the allegations in the Complaint, consented to the entry of final judgments of permanent injunction, enjoining them from future violations of the antifraud provisions. In addition, they agreed to cooperate with Commission staff in the continuing investigation and any resulting litigation.

The Complaint concerned the fraudulent offer and sale of over $2.1 billion in municipal securities issued in 1993 and 1994 by Orange County, the Orange County Flood Control District, and a school district located within

Orange County. The Complaint alleged that Citron and Raabe made material misstatements and omissions of fact in the Official Statements for eleven municipal securities offerings, regarding:

- the Orange County Investment Pools, including the County Pools' investment strategy and investment results, manipulation of the County Pools' yield and investment in the County Pools of the funds pledged to repay the municipal securities. These matters affected the issuer's ability to repay the securities and the County Pools' ability to perform under agreements to repurchase or provide for repayment of the securities;

- Orange County's financial condition, including its economic reliance on interest income from the County Pools as a source of funds to repay the purchasers of the securities;

- the tax-exempt status of certain offerings;

- an undisclosed interest rate cap on variable rate securities sold in certain offerings; and

- the unauthorized use of an audit report in certain offerings.

In addition, Raabe made misrepresentations to national securities rating agencies concerning the County Pools in connection with certain offerings.

To Contents

Securities and Exchange Commission v. Louis Bethune, Charles L. Howard and John Jackson, Civ. Action No. CV:95-B2509 (N.D. Ala.), Litigation Release No. 14675 (October 2, 1995) (complaint).

The United States Securities and Exchange Commission ("Commission") announced that on September 29, 1995, a complaint was filed in the United States District Court for the Northern District of Alabama seeking to permanently enjoin Louis Bethune ("Bethune"), Charles Howard ("Howard") and John Jackson ("Jackson") from further violations of the antifraud provisions of the federal securities laws. Bethune and Howard are longtime residents of Birmingham. Jackson is the mayor of a White Hall, a small town in central Alabama. The complaint alleges that the defendants participated in a fraudulent scheme to pledge $300 million in revenue bonds purportedly issued by the Redevelopment Authority of White Hall ("Authority") in an attempt to obtain a $255 million margin loan from a Sarasota, Florida office of Smith Barney, Inc. ("Smith Barney"). The complaint also alleges that prime bank securities do not exist and that all series of the bonds issued by the Authority contained multiple misrepresentations, including fundamental misrepresentations that the bonds were "Bank Guaranteed," and that they were backed by "Prime Bank Securities, issued by an acceptable institution in good standing, rated AA+ or higher by Standard & Poors. "The complaint seeks a permanent injunction, an order imposing civil monetary penalties on the defendants and other equitable relief.

To Contents

Securities and Exchange Commission v. Louis Bethune, Charles L. Howard and John Jackson, Litigation Release No. 15024 (August 26, 1996) (settled final order).

The United States Securities and Exchange Commission ("Commission") announced that on August 8, 1996, the Honorable Sharon Lovelace Blackburn of United States District Court for the Northern District of Alabama entered a final judgment of permanent injunction against defendant John Jackson, Mayor of White Hall, Alabama, prohibiting Jackson from future violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934. Jackson consented to the entry of the permanent injunction against him without admitting or denying the allegations of the complaint.

The Commission's complaint, filed September 29, 1995, alleged that the defendants participated in a fraudulent scheme to pledge $300 million in revenue bonds purportedly secured by prime bank securities and issued by the Redevelopment Authority of White Hall ("Authority") in an attempt to obtain a $255 million margin loan from a Sarasota, Florida office of Smith Barney, Inc. ("Smith Barney"). The complaint also alleges that prime bank securities do not exist and that all series of the bonds issued by the Authority contained multiple misrepresentations, including fundamental misrepresentations that the bonds were "Bank Guaranteed," and that they were backed by "Prime Bank Securities, issued by a an acceptable institution in good standing." See also, LR.-14675/October 2, 1995.

To Contents

Securities and Exchange Commission v. Louis Bethune, Charles L. Howard and John Jackson, Litigation Release No. 15271 (February 28, 1997) (settled final order).

The Securities and Exchange Commission announced today that on February 20, 1997, the Honorable Sharon Lovelace Blackburn, United States District Judge for the Northern District of Alabama, entered a final judgment of permanent injunction against defendant Charles L. Howard ("Howard"), enjoining him from violating Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Upon sworn representations of a financial inability to pay a fine, no civil penalties were imposed. Howard consented to the relief without admitting or denying the allegations set forth in a complaint filed by the Commission on September 29, 1995. The complaint alleged that Howard, along with codefendants Louis Between and John Jackson, violated the antifraud provisions of the securities laws in the offer and sale of municipal bonds, the proceeds of which were to be used for downtown redevelopment projects in White Hall, Alabama. Howard and codefendant Bethune persuaded city officials to allow them to sell the bonds at face values disproportionate to the costs of the projects being funded by the bonds. The complaint also alleged that Howard and his codefendants misrepresented to investors that the bonds were backed by "Prime Bank Securities. "In fact, none of the bonds offered for sale by Howard were ever

guaranteed or secured by any financial instrument which could be described as a prime bank security.

To Contents

Securities and Exchange Commission v. Terry D. Busbee and Preston C. Bynum, Civ. Action No. 95-30024 RV (N.D. Fla.), Litigation Release No. 14387 (January 23, 1995) (complaint).

The Securities and Exchange Commission ("Commission") announced today that it filed a Complaint for Injunctive and Other Equitable Relief and Civil Money Penalties ("Complaint") in the United States District Court for the Northern District of Florida against Terry D. Busbee ("Busbee"), an elected public official of the Escambia County Utilities Authority ("ECUA") from approximately 1984 through 1994, and Preston C. Bynum ("Bynum"), an employee of Stephens Inc. ("Stephens"), a municipal securities underwriter. The Complaint alleges that from at least 1990 through at least 1993, the defendants defrauded the ECUA and investors in three offerings of municipal securities issued by the ECUA. According to the Complaint, Busbee and Bynum entered into certain financial arrangements, pursuant to which Busbee received certain benefits from Bynum, during a time when Busbee had an important role in selecting the underwriter for municipal securities issued by the ECUA. The Complaint alleges that Bynum caused the following benefits to be provided to Busbee: 1) the extension and guarantee of four loans totaling $36,700 from an Arkansas bank; 2) repayment of approximately $27,000 in principal and interest on three of the loans; and 3) payment of approximately $3,500 to Busbee directly. The Complaint further alleges that Busbee voted to select, and otherwise participated in the selection of Bynum's employer as the underwriter or senior managing underwriter for three ECUA municipal securities offerings.

According to the Complaint, Busbee and Bynum each had a duty to disclose the financial arrangements to the ECUA in connection with Stephens' selection as underwriter in the three offerings and to investors in the three offerings. The Complaint alleges that Busbee's and Bynum's failure to disclose the financial arrangements and the actual and potential conflicts of interest created by those arrangements, at the time Bynum's employer was selected as underwriter and at the time those ECUA securities were offered and sold to the public, violated the following antifraud provisions of the federal securities laws: Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder. In addition, the Complaint alleges that Bynum also violated Rules G-17 and G-20 of the Municipal Securities Rulemaking Board ("MSRB"), which prohibit unfair practices in the conduct of municipal securities business and place limitations on gifts in relation to certain municipal securities activities, and Section 15B(c)(1) of the Exchange Act, which prohibits effecting transactions in municipal securities in contravention of any rule of the MSRB.

In its Complaint, the Commission seeks permanently to enjoin both defendants from violating the antifraud provisions described above, and to enjoin Bynum from violating MSRB Rules G-17 and G-20, as well as Section 15B(c)(1) of the Exchange Act. In addition, the Commission seeks orders requiring each of the defendants to pay civil money penalties.

Also today, the United States Attorney for the Northern District of Florida announced that a federal grand jury indicted Busbee and Bynum on charges relating to the conduct alleged in the Complaint.

The Commission's investigation continues as to the conduct of other individuals and entities involved in this matter.

To Contents

Securities and Exchange Commission v. Terry D. Busbee and Preston C. Bynum, Litigation Release No. 14508 (May 24, 1995) (settled final order).

The Securities and Exchange Commission announced today that Terry D. Busbee and Preston C. Bynum agreed to settle the civil action brought by the Commission in United States District Court for the Northern District of Florida on January 23, 1995. Without admitting or denying the allegations contained in the Complaint, Busbee, an elected public official of the Escambia County Utilities Authority ("ECUA") from approximately 1984 through 1994, and Bynum, formerly an employee of the public finance department of Stephens Inc., consented to the entry of final judgments of permanent injunction providing for all of the equitable relief sought by the Commission.

The Complaint filed by the Commission alleges that from at least 1990 through at least 1993, the defendants defrauded the ECUA and investors in three offerings of municipal securities issued by the ECUA. According to the Complaint, Busbee and Bynum entered into certain financial arrangements, pursuant to which Busbee received certain benefits from Bynum, during a time when Busbee had responsibility for selecting the underwriter for municipal securities issued by the ECUA. The Complaint alleges that Bynum caused the following benefits to be conferred on Busbee: (1) the extension and guarantee of four loans totaling $36,700 from an Arkansas bank; 2) repayment of approximately $27,000 in principal and interest on three of the loans; and 3) payment of approximately $3,500 to Busbee directly. The Complaint further alleges that Busbee voted to select, and otherwise participated in the selection of Bynum's employer as the underwriter or senior managing underwriter for three ECUA municipal securities offerings. See Litigation Rel. No. 14387 (January 23, 1995).

Bynum has consented to the entry of a final judgment that permanently enjoins him from future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 15B(c)(1) of the Exchange Act and Rules G-17 and G-20 of the Municipal Securities Rulemaking Board. In addition, Bynum also has agreed to pay a civil money penalty in the amount of $25,000. Busbee also has consented to the entry of a final judgment that permanently enjoins him from future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and that notes that no penalty is imposed on Busbee based on his demonstrated inability to pay.

As part of the settlement, Bynum has also agreed to the issuance by the Commission of an Order Instituting Proceedings, Making Findings and Imposing Sanctions, that bars him permanently from association with any

entity regulated by the Commission.

Last week, H. Michael Patterson, the United States Attorney for the Northern District of Florida, announced that in related criminal proceedings, on May 17 Busbee was sentenced to twenty-seven months in prison, with three years probation for his violations of *18 U.S.C. § 666* (bribery concerning programs receiving federal funds) and *26 U.S.C. § 7206* (false statement on an income tax return); and that on May 18 Bynum was sentenced to a prison term of twenty-four months with two years probation, for his violation of *18 U.S.C. § 666*. Both defendants had previously pleaded guilty to those charges, on March 3, 1995.

The Commission acknowledges the assistance of the United States Attorney for the Northern District of Florida and the Criminal Investigation Division of the Internal Revenue Service.

The Commission's investigation continues as to the conduct of other entities and individuals involved in this matter.

To Contents

SEC v. Whatcom County Water District No. 13, et al., Civ. Action No. C77-103, (W.D. Wash.), Litigation Release No. 7810 (March 7, 1977) (complaint); Litigation Release No. 7592 (May 10, 1977) (settled final orders).

See "The Issuer" section.

To Contents

SEC v. Washington County Utility District, et al., Civ. Action No. CA-2-77-15 (E.D. Tenn.), Litigation Release No. 7782 (February 15, 1977) (complaint).

See "The Issuer" section.

To Contents

SEC v. Washington County Utility District, et al., Litigation Release No. 7868 (April 14, 1977) (settled final orders).

Jule B. Greene, Administrator of the Atlanta Regional Office of the Securities and Exchange Commission, announced that on March 30, 1977, the Honorable Charles G. Neese, Judge of the United States District Court for the Eastern District of Tennessee, Northeastern Division in Greeneville, issued orders of preliminary and permanent injunction from further violations of the anti-fraud provisions of the federal securities laws against Washington County Utility District ("WCUD"), of Washington County, Tennessee, a "municipality or public corporation", Commissioners Paul G. Puckett of Johnson City, Tennessee, and Stella B. Harwood of Jonesboro, Tennessee and Hertz N. Henkoff of Boston, Massachusetts, an attorney who

served as bond counsel for several issues of revenue bonds of WCUD.

WCUD was further directed to make an accounting of the receipt and disbursement of all funds received in connection with all revenue bonds it has issued.

Puckett and Harwood were ordered to disgorge certain bonds of WCUD in their possession and to pay over to the Clerk of the Court for the benefit of bondholders the proceeds from the sale of certain other bonds of WCUD.

In addition, Judge Neese signed an order of preliminary injunction with respect to Wade H. Patrick of Johnson City, Tennessee, the manager of WCUD and ordered that a trust be impressed upon all of his assets and that he make an accounting of all income, property or other assets received by him from WCUD or from other source as a result of activities involving WCUD.

Between 1965 and 1975 WCUD had made seven different bond offerings; four for its garbage division ($2,175,000) and three for its cable antenna television division ($1,500,000).

The complaint alleged numerous untrue statements of material facts concerning, among other things, the use of the proceeds obtained from the sale of revenue bonds issued by WCUD; the purposes for which the bonds were issued; the priority of liens of the bondholders on property owned by WCUD or its divisions; and the sufficiency of revenues in each division of WCUD to meet expenses including debt service. The complaint also alleged numerous omissions to state material facts including the following: that WCUD bonds were sold at substantial discounts, ranging from 10 to 42 percent; that WCUD prior to 1975 failed to have audited financial statements prepared; that WCUD was not making payments into a sinking fund to retire the bonds outstanding; that proceeds from the sale of bonds were used for purposes other than represented in prospectuses or authorized in the bond resolutions, such as loans to Patrick and companies controlled by Patrick or his relatives, payment of interest on prior issues of bonds, and loans or advances to other divisions of WCUD.

The individual defendants consented to the relief requested; the decree against WCUD was entered by default. For further information, see Litigation Release No. 7782.

To Contents

SEC v. Washington County Utility District, et al., Litigation Release No. 8410 (May 15, 1978) (settled final order).

Jule B. Greene, Administrator of the Atlanta Regional Office of the Securities and Exchange Commission, announced that on May 5, 1978, the Honorable Charles G. Neese, Judge of the United States District Court for the Eastern District of Tennessee, Northeastern Division, in Greenville, issued an order of permanent injunction from further violations of the anti-fraud provisions of the federal securities laws against Henry C. Miller of Johnson City, Tennessee, in connection with the offer and sale of revenue

bonds of Washington County Utility District, Washington County, Tennessee (WCUD) or any other security.

Miller was further ordered to waive claim to a bond of WCUD and monies paid over to the Clerk of the Court.

Between 1965 and 1975 WCUD had made seven different bond offerings; four for its garbage division ($2,175,000) and three for its cable antenna television division ($1,500,000).

The complaint alleged numerous untrue statements of material facts concerning, among other things, the use of the proceeds obtained from the sale of revenue bonds issued by WCUD; the purposes for which the bonds were issued; the priority of liens of the bondholders on property owned by WCUD or its divisions; and the sufficiency of revenues in each division of WCUD to meet expenses including debt service. The complaint also alleged numerous omissions to state material facts including the following: the WCUD bonds were sold at substantial discounts, ranging from 10 to 42 percent; that WCUD prior to 1975 failed to have audited financial statements prepared; that WCUD was not making payments into a sinking fund to retire the bonds outstanding; that proceeds from the sale of bonds were used for purposes other than represented in prospectuses or authorized in the bond resolutions, such as loans to the manager of WCUD or companies controlled by him or his relatives, and loans or advances to other divisions of WCUD.

Miller consented to the relief requested without admitting or denying the allegations in the Complaint. For further information, see Litigation Release Nos. 7782 and 7868.

To Contents

SEC v. Washington County Utility District, et al., 1982 U.S. Dist. LEXIS 17316 (E.D. Tenn. Dec. 2, 1982).

Opinion: NEESE, Senior District Judge: The Court hereby ADOPTS, as its own, the findings of fact and conclusions of law proposed jointly by the remaining parties and filed herein on November 3, 1982.

Proposed Findings of Fact and Conclusions of Law

The Plaintiff, Securities and Exchange Commission, and the Defendant, Wade H. Patrick, pursuant to order of this Court dated May 25, 1982, jointly present the following proposed Findings of Fact and Conclusions of Law:

Findings of Fact

I. Background

1. Washington County Utility District ("District") was organized under the laws of the State of Tennessee in 1955 as the Garbage Disposal District of Washington County, Tennessee. Its name was changed to its present form

in 1966. (Stipulation)

2. Wade H. Patrick has, since at least 1956, been manager of the District and has dominated and controlled its affairs. (Stipulation; Ex. 104B pp. 18-19, 78-80, 84-85; 105, p. 17; Alcock Tr. 51)

3. HPO Services, Inc ("HPO") is a company owned by Wade H. Patrick. (Ex. 102B pp. 64-65; Patrick Tr. 42-44)

4. Diversified Securities, Inc. ("Diversified") is a New York corporation owned by Thomas R. Alcock. (Stipulation)

5. Thomas R Alcock through Diversified Securities, Inc. or doing business as T.R. Alcock & Co. has acted as underwriter of all the bonds sold by the District since 1965 and as its fiscal agent. (Stipulation)

II. Bond Offerings

6. From 1965 through 1975 the District issued seven different bond issues; three were for its Community Antenna Television System Division (CATV), and four issues were for its Garbage Division. (Stipulation)

7. The total amount of the bonded indebtedness for the Utility District as a result of the bond offerings was $3,675,000. The bonds issued by the CATV Division total $1,500,000; the Garbage Division has issued a total of $2,175,000. (Stipulation)

8. Each of the issues of bonds was payable solely from revenue generated from the particular division which issued the bonds. (Stipulation)

9. Each of the bond resolutions authorizing the issuance of bonds by the District specified the purposes for which the funds were being raised. (Stipulation) The major purposes specified in the bond resolutions were as follows:

(a) The 1965 Garbage Division offering was to refund a prior bond issuance; (Ex. 4)

(b) The 1968 CATV Division offering was to construct a CATV system; (Prel. Ex. 11)

(c) The 1970 Garbage Division offering was to pay for the cost of constructing and acquiring extensions and improvements to the garbage disposal system including the acquisition of an additional landfill site; (Prel. Ex. 11)

(d) The 1971 CATV bond offering was to provide for the acquisition, construction and operation of extensions to the system; (Prel. Ex. 11)

(e) The 1972 Garbage Division bond offering was to provide funds for the cost of constructing and acquiring extensions and improvements to that system; (Prel. Ex. 11)

(f) The 1973 CATV bond offering was for the acquisition, construction and operation of extensions to that system; (Ex. 3)

(g) The 1974 Garbage Division bond offering was for the purchase and operation of a landfill. (Prel. Ex. 11)

10. Monies from each bond offering, with the possible exception of the 1965 Garbage Division Offering, were used for purposes other than those provided in the bond resolutions.

11. The bonds specifically stated that the District covenanted to charge sufficient fees to provide for the operation of the particular divisions including the payment of interest on the bonds and to provide for the retirement thereof. (Stipulation) The bonds further provided that the Tennessee laws required revenue to be sufficient to meet all such items. (Prel. Ex. 11, 12)

12. Even though the bonds specifically represented that the District would charge sufficient fees to cover the cost of operations, including the payment of interest and principal on the bonds issued, the District never charged sufficient fees to cover costs including amortization of the bonded indebtedness, and the only way it was able to continue its operations was through the fraudulent sale of additional bonds to cover the cost of operations, particularly interest on prior issues of bonds. (Tr. 80, 180-181)

13. It was expressly provided in the bond resolution that funds would be disbursed solely for the purposes for which the bonds were authorized and remaining funds would be put into a sinking fund which constituted a trust fund. (Stipulation)

14. Funds received from the sale of the bonds were regularly and routinely disbursed for purposes not disclosed in the bond resolutions, and no funds were ever put into a sinking fund for the retirement of the bonds as represented in the bond resolutions. (Prel. Tr. 40, Tr. 145-146, 158-159)

15. Each of the bond resolutions required that accurate records would be kept. (Prel. Ex. 11; Ex. 4)

16. Patrick knew that the records being kept by the District were totally inadequate and not accurate so as to reflect the use of funds and was repeatedly advised of the inadequacies of the books and records by the accountant engaged by the District. (Prel. Tr. 35-36; Tr. 84-86) Despite being told by the accountant for the District that the records were not accurate and not adequate, Patrick continued to make representations as to the accuracy of the records in all of the bond resolutions, which resolutions were incorporated by reference in each of the bonds. (Prel. Ex. 11; Ex. 4)

17. Each of the bond resolutions provided that the Utility District would have certified financial statements prepared yearly. The bonds incorporated by reference the resolutions authorizing the issuance thereof together with the representations contained therein. (Stipulation)

18. Patrick knew that the above representations contained in the bond resolutions, and in the bonds by incorporation, were false because the

Utility District never had an audited financial statement prepared until 1975. (*Tr. 84-85 Ex. 102, pp. 37-38* [6-29-76])

19. The law under which the Utility District was organized required that the Utility District have annual financial statements prepared. (Stipulation)

20. Although Patrick knew that the laws of the State of Tennessee required the Utility District to have annual financial statements prepared, he never advised or required that each purchaser of the bonds be advised that the Utility District was not complying with State law in that respect. (Tr. 193-196, Ex. 129)

21. Each bond resolution provided that the bondholders would have a lien on the assets owned or thereafter acquired by the Division of the District offering the particular bonds. (Stipulation; Ex 3; and Prel. Ex. 11)

22. Knowing full well that the first three issues of the Garbage Division had granted a lien on the assets owned or thereafter acquired by the Garbage Division of the Utility District, the District, with Patrick's knowledge, nevertheless falsely represented, in connection with the fourth issue of the Garbage Division's bonds, that the bondholders would have a first lien on certain properties which the Garbage Division had already acquired and to which a lien had attached in favor of the bondholders of the three previous bond offerings. (Tr. 166-167)

III. Financial Condition of the District

23. The Garbage Division operated at a loss for the fiscal years 1969 and 1970. (Prel. Tr. 26; Prel. Ex. 1)

24. Washington County Utility District is and has been insolvent since at least June 30, 1973, in that its assets are less than its liabilities. (Stipulation)

25. For the fiscal year ending June 30, 1973, its liabilities exceeded its assets by over $200,000. For the fiscal year ending June 30, 1974, the liabilities of the District exceeded its assets by over $337,000. (Stipulation)

26. The deficit for the fiscal year ended June 30, 1975, increased to over $550,000, and by the year ended June 30, 1976, the liabilities exceeded the assets by over $656,000. This excess of liabilities over assets has increased for the year ending June 30, 1977, to over $813,600. (Stipulation)

27. As of June 30, 1974, the total bonds payable by the District exceeded the total assets by over $225,000; by June 30, 1976, the total bonds payable exceeded the total assets by over $300,000; and by June 30, 1977, the total bonds payable exceeded total assets by over $338,000. (Prel. Ex. 5 & 17; Ex. 1; Prel. Tr. 53)

28. If the amount of depreciation and amortization could be calculated, the effect would be to further increase the deficit. (Prel. Tr. 38-39, 53; Tr. 80-81)

29. The Statute of the State of Tennessee requiring utility districts to prepare annual financial statements was ignored by the District until at least 1974. (Stipulation) J. B. Holt, a certified public accountant, did accounting work for the District from 1958 through 1974, and repeatedly told Patrick that the District's books and records were inaccurate and inadequate. (Prel. Tr. 23-24; Tr. 84-86) Holt, in 1975, completed an audit of the District for the fiscal years ending June 30, 1973, and June 30, 1974. (Prel. Tr. 37; Prel. Ex. 5)

30. The financial statements prepared by Holt were not certified as required by the bond resolutions and the laws of Tennessee because, among other deficiencies, depreciation of fixed assets and amortization of bond costs could not be calculated since records were incomplete. (Stipulation; Prel. Tr. 35-36; Tr. 80-81, 100-101)

31. The District's liabilities exceeded its assets by approximately $230,000 at June 30, 1973 (Stipulation); this was not disclosed in the bond resolution dated April 1, 1974, for the fourth issue of Garbage Division Bonds. (Prel. Ex. 11)

32. There was no disclosure that the District was not and had not been charging sufficient fees to meet all expenses. (Lamberson Tr. 29, 33-35; Carty Tr. 19, 23-24; Glidden Tr. 9, 12-13, 32, 35; Ex. 47, 102 p. 25; Prel. Ex. 5, 16, 17)

33. Patrick signed and caused to be issued an unaudited earnings statement for the Garbage Division for the six months ending December 31, 1973, to be utilized in the offering and sale of the Garbage Division's fourth issue of bonds which earnings statement represented that the Garbage Division was operating at a profit. (Tr. 181-182, Ex. 47)

34. Patrick, subsequent to April 1974, falsely represented to William Carty, a principal of the broker-dealer selling the Fourth issue of bonds of the Garbage Division, that "the District was operating profitably and everything was all right" when Carty called and expressed concern about the market for the bonds. (Carty Tr. 19) Patrick omitted to tell him material facts, including but not limited to the following: that the District had never had an audited financial statement prepared, and consequently, could not ascertain what its condition was; that records of receipts and expenditures were not appropriately maintained; that the District's assets were less than its liabilities; that the District's Divisions were not operating at a profit; that funds of one Division were used for another Division without receiving interest; that such inter-division transfers were used to keep outstanding bonds current by payment of interest; and that funds were loaned to Patrick, his friends and relatives. (Carty Tr. 20-32)

35. Broker-dealers would not have purchased bonds of the District or sold the District's bonds to their customers if apprised that the District was insolvent in that its liabilities exceeded its assets, or if purchased, it would only be for clients who were absolute speculators who purchased such bonds at five cents on the dollar. (Michaels Tr. 14; Carty Tr. 30, 32; Glidden Tr. 35-36; Lamberson Tr. 22-23)

IV. Misuse of Bond Proceeds

36. Patrick caused the District to use proceeds from one bond offering to pay interest on other bond offerings (Prel. Tr. 43, Ex. 1); even though the bond resolutions required that the funds be expended only for the purpose for which such bonds were issued and any funds remaining were to be put in a sinking fund which was to constitute a trust fund. (Stipulation; Tr. 85-86; Prel. Tr. 28-29, 42-43) Patrick as manager and controlling person caused this course of business. He handled all receipts and disbursements of funds by the District without direction or authority from the Commission except in a few instances. (Ex. 103, p. 80; Ex. 104, p. 97; Ex. 105, p. 41, 59, 75)

37. Despite the fact that each of the bond resolutions required sinking fund payments to be made for the purposes of retiring the bonds as they came due, the Utility District has not made any sinking fund payments and Patrick did not disclose such information to purchasers of the District's bonds. (Prel. Ex. 5, 11, 16, 17; Ex. 1; Prel. Tr. 54-55)

38. Despite the fact that the bonds issued by the CATV Division and the Garbage Division are revenue bonds payable solely from revenues generated by the appropriate Division, monies have been advanced from one Division of the District to another Division of the District without the payment of interest by the borrower Division. In fact, no interest has ever been paid on advances from one Division to another. (Stipulation)

39. Broker-dealers would not have sold the District's bonds to their customers if they had known that proceeds of the bond offerings of one Division were being loaned to another Division without interest or documentation. (Michaels Tr. 15; Glidden Tr. 18-19)

A. 1970 Garbage Division Bond Offering

40. The 1970 bond offering by the Garbage Division was for the purpose of acquiring a landfill for the District. The offering of $650,000 in bonds was authorized by the Commissioners on July 20, 1970. (Stipulation; Prel. Ex. 11)

41. An offering circular utilized in the sale of these bonds by T. R. Alcock represented that the cost of the property to be acquired by the District was $297,500, fraudulently omitting the material fact that the property was to be acquired from Patrick and Alcock at a profit to them of approximately $225,000. (Prel. Ex. 20)

42. No disclosure was made in the bonds, the bond resolution nor the sales literature that of the $297,500 approximately $228,000 in bonds were to be issued to Patrick and Alcock for the transfer of an option to purchase the property for $70,000. (Prel. Tr. 64-65; Prel. Ex. 10, 11 & 12; Alcock Tr. 56-68, 97-98)

43. Patrick omitted to disclose that 6 months prior to transferring the option to the Utility District he paid only $2,000 or $3,000 for the option. (Ex. 102 pp. 35-36; Ex. 102B pp. 8-9; Prel. Tr. 63-65)

44. While the District, in fact, did not pay Patrick $228,000 for the transfer of the option, Patrick did receive approximately $70,000 in bonds, the

cancellation of indebtedness, payment of debt and other consideration. (Prel. Tr. 66-67; Ex. 102B pp. 9-10; 102A pp. 107) This was never disclosed. (Prel. Ex. 11 & 12; Glidden Tr. 28-29; Lamberson Tr. 43) $40,000 par value bonds were given by Patrick to Commissioners Harwood, Miller and Puckett, which have subsequently been disgorged pursuant to the Commissions' settlements. (Tr. pp. 122, 158-159)

45. Bonds or a part thereof received by Patrick in connection with the sale of the option to the District were transferred to the Commissioners without consideration. (Ex. 102 pp. 28-29; 102B pp. 9-10; 103 pp. 70-71) Bondholders were never advised of this fact. (Prel. Ex. 11 & 12)

46. Alcock was paid $32,500 in fiscal agent's fees of which one-half or $16,250 was paid to Patrick. (Alcock Tr. 22-25)

47. Commissioners are prohibited by statute from receiving compensation for their services unless specifically authorized and then they are limited to $600 per year. (Judicial Notice – Tenn. Annotated Statute Ch. 26, Sec. 6-2615; Stipulation)

B. 1971 CATV Division Bond Offering

48. Holt prepared and sent to Patrick a schedule of receipts and disbursements for the 1971 CATV Division bond offering which reflected that the District realized only a total of $378,000 including over $10,000 in accrued interest from the sale of bonds with a face amount of $500,000. (Prel. Tr. 32-34; Prel. Ex. 4)

49. Despite the fact that the fiscal agent's fees were excessively set at five or six percent of face rather than the net amount received, Alcock was paid $38,000, of which one-half or $19,000 was paid to Patrick, from the 1971 CATAV Division bound offering which is almost eight percent of par. In addition, over $82,000 was paid in interest on bonds from the proceeds, and the maximum amount which could have been paid by July 31, 1973, on the 1971 bonds was only $49,500; thus pursuant to Patrick's direction there was a diversion of over $32,000 for other issues. (Prel. Ex. 4; Alcock Tr. 22-23)

C. 1972 Garbage Division Bond Offering

50. In July 1972, the District authorized the issuance and sale of $500,000 in Revenue Bonds for the Garbage Division for the purpose of "constructing and acquiring extensions and improvements to the system." (Prel. Ex. 11) The District received $400,000 for the $500,000 face amount of the bonds. (Prel. Ex. 5 & 16) All of the bonds were acquired by Alcock at a discount of twenty (20) percent. (Prel. Tr. 27, 41; Prel. Ex. 2; Ex. 21) In addition, the District paid to Alcock or Diversified $57,000 as a fiscal agent's fee, of which one-half or $28,500 was paid to Patrick. Also, it paid legal and auditing expenses of $7,247.11. From the bond proceeds, bond interest and fees of $11,191 were paid. Moreover, from the bond proceeds, funds were diverted in the form of loans directly to Patrick of $11,500 and to D & P Development Co., a partnership in which he had an interest, of $125,000. Bullington Enterprises, an entity controlled by Patrick's son and son-in-law also received $45,000 as a loan. All of the aforesaid loans have been repaid

with interest. From the $400,000 of proceeds realized by the District in this bond offering only $65,874.55 was actually expended for the acquisition of equipment and the construction of improvements to the Garbage Division System. (Prel. Ex. 5, 16; Prel. Tr. 41-45)

51. At Patrick's direction at least $189,000 of the proceeds of the 1972 Garbage Division bond offering, was eventually used for a proposed sewer project contrary to the provisions of the bond resolution. (Prel. Ex. 2; Prel. Tr. 28-29; Tr. 160-161)

52. Only one month after misapplying bond proceeds in the form of loans to Bullington Enterprises and D & P Development, the District borrowed funds from a finance company to purchase a truck for the District. (Stipulation; Prel. Ex. 8; Tr. 159-160)

D. 1973 CATV Division Bond Offering

53. Only $309,000 was realized by the District from the sale of $400,000 face amount of the 1973 CATV Division bonds. The proceeds together with the $6,135.27 of interest thereon were commingled with $7,000 transferred from the Garbage Division. From such funds and at Patrick's direction $90,375 was used to pay interest on prior bond issues, including Garbage Division issues; $21,875 was used to pay fiscal agent's fees, of which one-half or $10,937.50 was paid to Patrick; and $3,825 was used to pay legal, printing and audit costs. The sum of $5,500 was transferred to the Sewer Division, and $1,000 was transferred to the Transit Division. (Prel. Ex. 5, 16)

54. Alcock knew, before all bonds of the 1973 CATV issue were sold, that the District was about to default by non-payment of interest and conspired with Patrick to pay the interest to conceal the District's financial plight. As consideration for agreement to pay the interest, Alcock was permitted to buy $50,000 of the bonds at a forty-two (42) percent discount with payment for the bonds being deferred over a period of nine months. (Prel. Ex. 6; Ex. 21, 102B p. 55; Alcock Tr. 76-78)

55. Bonds of the third issue of the CATV Division were sold to Carty & Co., Inc., a Memphis broker-dealer, for $990,000 per hundred in 1973 and then resold to customers and other brokers for prices ranging from $89.00 to $97.15. (Michaels Tr. 5-7; Carty Tr. 24-27; Ex. 46)

56. Broker-dealers were not told the above-mentioned material facts and would not have solicited purchases of the District's third issue of CATV Division's bonds at $90.00 per hundred if they had known that the underwriter had paid only $58.00 per hundred for some of the bonds and even in unsolicited trades would have advised purchasers of the fact that the underwriter had paid substantially less for some of the bonds. (Michaels Tr. 18; Carty Tr. 27-28)

E. 1974 Garbage Division Bond Offering – Landfill

57. The 1974 Bond Offering by the Garbage Division was in the amount of $675,000. Alcock sold, by the end of June, 1974, bonds with the face amount of $500,000 at seventy-five (75) percent of par; the District thus

realized $375,000 before expenses. (Prel. Ex. 5; Ex. 21)

58. Patrick and Alcock agreed to use proceeds for purposes other than stated in the bond resolution. (Stipulation; Ex. 55-61, 64, 109, 114; Prel. Ex. 5 & 16)

59. The District paid Alcock $33,750 in fiscal agent's fees of which one-half or $16,875 was paid to Patrick. (Alcock Tr. 22-25)

60. Diversified deposited through May 14, 1975 proceeds of $481,641.94 in its client's funds account from the sale of the Garbage Division's 1974 bond issue from the sale of $635,000 face amount of bonds at seventy-five (75) percent of par. (Ex. 114)

61. Alcock personally handled the distribution of funds from the 1974 Garbage Division bond offering. With Patrick's consent over $140,000 was used for the CATV Division contrary to the provisions of the bond resolution. (Ex. 114; Stipulation; Tr. 166-168)

62. Patrick received a loan of $9,000 and Bullington Enterprises received a loan of $10,000 from funds diverted from the bond proceeds (Prel. Ex. 5), both of which have been repaid.

63. In addition to the $64,000 bond interest paid for CATV Division, Patrick paid bond interest on earlier issues of the Garbage Division of over $40,000 contrary to the provisions of the bond resolution. (Prel. Ex. 5, 16; Ex. 114)

64. The Sewer Division received $9,000 from the proceeds of the 1974 bond offering at Patrick's direction. (Prel. Ex. 5 & 16)

65. Although the purported purpose of the 1974 bond offering was to purchase a landfill, only $20,550 was used to partially pay for the Bowers' property, after Patrick caused the District to issue bonds with a face amount of $675,000. (Prel. Ex. 5, 16)

66. Michaels, a representative of Carty & Co., Inc. a broker-dealer, understood proceeds from the Fourth Issue of Bonds of the Garbage Division were to be utilized only for purposes stated in the offering circular. (Michaels Tr. 14)

67. Because of the information furnished to it, Carty & Co., Inc. purchased $600,000 face amount of the Fourth Issue of the Garbage Division at $80.00 per $100 face amount from Cecil Lamberson. The bonds were then resold to the public at prices ranging from $82 to $89 per $100 face amount. (Ex. 46; Michaels Tr. 11; Carty Tr. 8-14)

68. At the time the purchase of the Fourth issue of bonds of the Garbage Division was agreed upon between Lamberson and Carty & Co., an offering circular and an up-to-date financial statement of the District was requested by representatives of Carty & Co. (Michaels Tr. 11; Carty Tr. 15)

69. Broker-dealers would not have purchased the bonds or sold the bonds of the Fourth Issue of the Garbage Division had they known that proceeds of the bond offering were to be used to pay interest on prior bond issues.

Such information was considered material. (Michaels Tr. 14; Glidden Tr. 18-19)

70. The offering circular for the Fourth Issue of the Garbage Division of the District represented that $68,000 of the proceeds were to be used to purchase land and $204,000 was to be used to pay off equipment notes and was so understood by representatives of Carty & Co. who sold the bonds to the public. (Ex. 47; Michaels Tr. 19) With the benefit of all inferences to the defendants only $37,350 could have been used to pay for real estate and only $167,093.97 was used to pay for equipment. (Prel. Ex. 16; Ex. 114)

V. False Representation That Bondholders of the Garbage Division's Fourth Bond Offering Would Have a Superior Lien

71. The Utility District's Garbage Division has utilized only one landfill since its organization in which it had a beneficial interest, that being the landfill commonly referred to as the Jonesboro site. The Garbage Division at no time had a special landfill for the refuse of residential users of the service as opposed to refuse of commercial or industrial users of the service. (Stipulation)

72. As early as 1973 the State of Tennessee was demanding that the Utility District take steps to close its Jonesboro site. At the time of trial the Utility District had closed its Jonesboro site and was utilizing the landfill site owned by the City of Johnson City. (Stipulation)

73. The resolutions for the 1965, 1970 and 1972 Garbage Division bond offerings, which were made at Patrick's direction, provided that the bondholders would have a lien on all property then owned by the Garbage Division or thereafter acquired by the District for the Garbage Division. (Stipulation; Prel. Ex. 11; Ex. 4)

74. The fourth issue of the Garbage Division, in 1974 in the face amount of $675,000, was for the specific purpose of acquiring a landfill. (Prel. Ex. 11) In fact, no properties were acquired by the District subsequent to the offer and sale of such bonds. (Prel. Ex. 9, 16 & 17; Ex. 102B pp. 27 & 35)

75. The bond resolution, for the fourth issuance of bonds for the Garbage Division provided, with Patrick's knowledge and consent, that the bondholders would have a first lien on the property to be acquired for the District. Since the prior shareholders already had a lien on the property owned by the District for the Garbage Division, this representation was false and totally misleading. (Stipulation; Prel. Ex. 11)

VI. Omissions of Material Facts concerning Fiscal Agents Fees Paid by the District and the Financial Feasibility of the Offerings

76. Customary discount in municipal bond underwritings are one and one-half (1 1/2) to two and one-half (2 1/2) percent of par. Discounts of three (3) to five (5) percent are unusual but at times are given. (Prel. Tr. 14)

77. The cost of a bond offering requiring discounts of ten (10) percent and fiscal agent's fees of five (5) percent plus the issuer paying the cost of the

issue is exhorbitant as a general rule. (Prel. Test. pp. 15-16)

78. A revenue bond offering providing for a twenty (20) percent discount is very risky, fiscally not feasible nor advisable. (Prel. Tr. 17)

79. Increasing the discount to twenty-five (25) percent results in an exhorbitant cost and a discount of thirty (30) percent becomes disastrous. (Prel. Tr. 17)

80. When Patrick's knowledge and consent, bonds of the second Garbage Division offering were sold by the District at prices ranging from sixty-five (65) percent to ninety (90) percent of par value, or at discounts ranging from ten (10) percent to thirty-five (35) percent and $445,000 of the par value of bonds of this issue were exchanged at par value for certificates of indebtedness. (Ex. 116)

81. With Patrick's knowledge and consent, the third Garbage Division issue was sold by the District at a discount of twenty (20) percent. (Ex. 116)

82. With Patrick's knowledge and consent, the fourth Garbage Division issue was sold by the District at discounts from seventeen and one-half (17 1/2) percent to twenty-five (25) percent of par value. (Ex. 116)

83. With Patrick's knowledge and consent, the first CATV Division issue was sold by the District at discounts from twenty (20) percent to fifty (50) percent of par value. (Ex. 116)

84. With Patrick's knowledge and consent, the second CATV Division issue was sold by the District at discounts from twenty-five (25) percent to forth (40) percent of par value.

85. With Patrick's knowledge and consent, the third CATV Division issue was sold by the District at discounts of twenty (20) percent and forty-two (42) percent of par value. (Ex. 5)

86. Of the $400,000 face amount 1973 CATV Division bond offering with Patrick's knowledge and consent, $350,000 were sold at $80 per hundred and the balance, namely $50,000, was sold to Alcock at $58 per hundred which was a discount of forty-two (42) percent. (Prel. Tr. 47; Prel. Ex. 5) Only one-half of the consideration, $14,500, was paid by June 30, 1974 although the sale was in January, 1974. The other $14,500 was not paid until December 13, 1974. (Prel. Ex. 6; Alcock Tr. 71-83)

87. The purported reason Alcock was getting such a substantial discount on the 1973 bond offering was his agreement to pay interest on the 1973 CATV Division bonds coming due in March and September 1974 to prevent default on the bonds which Patrick knew was not being told to purchasers of the bonds. (Prel. Ex. 6)

88. From the difference between the par value and the price paid by the underwriter (discount) the underwriter usually pays all legal, accounting and fiscal agent's fees; however, the District paid all legal, accounting and fiscal agent's fees in addition to the tremendous discounts. (Prel. Tr. p. 14-15) (Prel. Ex. 5, 16, 17; Ex. 116)

89. The District, at Patrick's direction, agreed to pay Diversified fiscal agent's fees from 1965 to 1975, as follows: 1965 Garbage Division 5% of $350,000 or $17,500; 1968 CATV Division 5% of $600,000 or $30,000; 1970 Garbage Division 5% of $650,000 or $32,000; 1971 CATV Division 5% of $500,000 or $25,000; 1972 Garbage Division 6% of $500,000 or $30,000; 1973 CATV Division $25,000 and 1974 Garbage Division 5% of $675,000 or $33,750. (Prel. Ex. 5, 16, & 17; Ex. 9, 10, 11, 116; Alcock Tr. 22-23)

90. For the fiscal year ending June 30, 1973, Alcock received fiscal agent's fees from the 1972 Garbage Division bond offering of $57,000 rather than the $30,000 per agreement. For the fiscal year ending June 30, 1974, Alcock received fees of $46,875 as fiscal agent and $8,208.54 for the fiscal year ending June 30, 1975, or a total of $55,083.54. (Prel. Ex. 5, 16, 17)

91. Patrick unlawfully received one-half of such fiscal agent's fees. (Alcock Tr. 22-23; Tr. 145-156)

92. Patrick authorized Alcock to obtain the bonds of the District at discounts ranging between ten (10) and forty-two (42) percent. Most of the bonds were at discounts of twenty (20) percent or more. The Commissioners were not advised by Patrick prior to the issuance of the bonds what discount would be granted to Alcock. (Alcock Tr. 76-80; Prel. Ex. 5, 6, 11, 13, 15, 16 and 17; Ex. 8 [4/30/68], 16, 17, 21, 50, 89, 93 102B pp. 51-57)

93. The discounts permitted by Patrick were not disclosed. (Lamberson Tr. 18-19; Alcock Tr. 83; Glidden Tr. 20)

94. Despite the abnormal discounts authorized by Patrick the bonds of the District were offered and sold at substantial markups including par or face value by Alcock and others. (Ex. 2, 20, 30, 33, 38, 40, 42, 45, 46, 72, 110, 111; Prel. Ex. 13)

VII. The District Exceeded the Statutory Interest Limit

95. The interest rate on Utility District revenue bonds cannot exceed eight (8) percent. (Judicial Notice – Tenn. Annotated Statute Ch. 26, Sec. 6-2620; Prel. Tr. 17-19; Stipulation)

96. Patrick caused the CATV Division to exceed the statutory rate of interest limitation; the interest being eight and eighty-two one hundredths (8.82) percent. (Prel. Tr. 17-18)

VIII. Misrepresentations and Omissions of Material Facts Concerning the District's Financial Condition, Records and Management's Conflicts of Interest

97. The District did not maintain accurate books and records. (Prel Ex. 5, 16, Ex. 1; Stipulation)

98. The District bond resolutions presented to the Commissioners by Patrick in 1970, 1972 and 1974 directing the issuance and sale of bonds for the Garbage Division do not disclose that the required sinking fund payments were not met on the prior issues. (Prel. Ex. 11)

99. The District bond resolutions for the CATV Division in 1971 and 1973 presented to the Commissioners by Patrick do not disclose that the required sinking fund payments had not been made as required by the prior bond resolution for the CATV Division. (Prel. Ex. 11; Ex. 3)

100. The conflicts of interest of Patrick and Alcock, including but not limited to the division of fiscal agent's fees with Patrick and Patrick's misapplication of bond proceeds, were not disclosed to investors. (Carty Tr. 21-22, Michael Tr. 15-17, Lamberson Tr. 34-35, Glidden Tr. 12-14, 20, 26-29, 41-42; Prel. Ex. 11 & 12; Ex. 2, 20 & 47)

IX. Funds Unlawfully Diverted to Patrick or Affiliates

101. Patrick dominated and controlled the District and its affairs. (Ex. 104B pp. 78-80, 84-85; 105 p. 17; Alcock Tr. 51)

102. Patrick obtained payments from Alcock of one-half the fiscal agent's fees which totaled $96,604.27. (Prel. Tr. pp. 73-74; Ex.102B p. 44; Alcock Tr. 24-28; Prel Ex. 5, 16, 17, Ex. 9. 10, 11, 116, 117)

103. Broker-dealers would not have purchased bonds of the District or sold such bonds to customers if they had been apprised that Alcock, the fiscal agent and underwriter, was making kickbacks to Patrick, the District manager. (Michaels Tr. 15; Glidden Tr. 13-14)

104. From January 1, 1970 to June 30, 1977 Patrick received $97, 450 in salary from the District. (Ex. 117)

105. Diversified with Patrick's knowledge and consent improperly paid from the proceeds of the District's 1974 Garbage Division offering, which proceeds had been deposited in its clients' funds account, $712.50 in legal fees and $2,500.00 in accounting fees in connection with an Internal Revenue Service inquiry into the personal tax returns of Patrick and Alcock. (Ex. 94, 95, 114, 133; and Alcock Tr. 126-128, 130-131)

106. Patrick authorized Diversified to pay from the proceeds of the District's 1974 Garbage Division bond offering, legal and professional fees of $865.00 and $250.00 in connection with Eastern TV Cable Corp., a company owned by Alcock. (Ex. 94, 114, 133; Alcock Tr. 128-130)

107. Property of the District was commingled with property of Patrick. (Patrick Tr. pp. 57-66)

108. There was no disclosure in the bonds or in the bond resolutions of the loans to Patrick or his affiliates. (Stipulation; Prel. Ex. 11, 12; Ex. 3, 4)

109. Broker-dealers would not have purchased the bonds of the District or sold them to their customers if aware that Patrick was causing the District to loan proceeds of the bond offerings to himself, relatives or entities in which he or his relatives had a beneficial interest. (Michaels Tr. 15; Glidden Tr. 26-32; Lamberson Tr. 21-22)

110. Patrick's self-dealing, besides making and receiving loans and selling land to the District, included obtaining $23,316.66 in commissions for the

sale of equipment to the District (Prel. Tr. 72; Ex. 102 pp. 33-35; 117; Patrick Tr. 35-38)

111. The District paid $10,000 to General Electric for D & P Development Company at Patrick's direction in connection with the sale to the District of the option to purchase the Milhorn property. (Ex. 117)

112. Patrick received four (4) $4,500 bonds with a total face value of $20,000 of the 1970 Garbage Division issue in connection with the sale to the District of the option to purchase the Milhorn property. (Ex. 117)

113. Patrick received four (4) $4,500 bonds with a total face value of $20,000 of the 1971 CATV Division issue which were sold for total proceeds of $13,316.66. (Ex. 117)

114. Patrick sold 15,000 par value of the CATV Division's first issue of bonds to T.R. Alcock & Co. on April 26, 1973 for $10,500. (Ex. 49, 50) On May 3, 1973, the District deposited $10,500 from T.R. Alcock & Co. to its bank account and credited Patrick for monies he had previously received from the District. (Ex. 118)

115. Patrick and his wife jointly owned four (4) lots in Johnson City, Tennessee, which they leased to the District at a rental of $400 per month since about 1968. The District at such a rate has paid Patrick $34,000 from December 1, 1968 through December 1975. (Ex. 102B pp. 49-50)

116. No accounting was made by Patrick or the District for the proceeds of the sale of the District's bonds and certificates of indebtedness or transactions between Patrick and the District prior to January 1, 1970, nor of any rents that may have been paid by the District to Patrick. (Ex. 102B pp. 49-50; Ex. 116, 117, 118, 119 & 121)

117. Patrick's brother, a sister, a son, a son-in-law, a daughter and sister-in-law were on the payroll of the District (Ex. 102A p. 108; 103 p. 81; 104B p. 4, 45, 67, 81; 105 p. 68-69; Patrick Tr. p. 13-14)

118. The District at Patrick's direction paid $1,250 to J. B. Holt for accounting fees in connection with the Internal Revenue Service Audit of Patrick personally. (Ex. 118)

119. Simple interest computed at the rate of eight (8) percent on half the fiscal agent's fees received by Patrick from Alcock or Diversified is as follows:

1965
Garbage $8,750.00 at 8% From 6/30/66 to 6/30/79=13 yrs. $9,100.00
1968
CATV $15,000.00 at 8% From 6/30/69 to 6/30/79=10 yrs. $12,000.00
1970
Garbage $16,250.00 at 8% From 6/31/71 to 6/30/79=8 yrs. $10,400.00
1971
CATV $12,500.00 at 8% From 6/30/72 to 6/30/79=7 yrs. $7,000.00
1972

Garbage 1973	$15,000.00 at 8% From 6/30/73 to 6/30/79=6 yrs.	$7,200.00
CATV 1974	$12,500.00 at 8% From 6/30/74 to 6/30/79=5 yrs.	$5,000.00
Garbage	$16,604.27 at 8% From 6/30/75 to 6/30/79=4 yrs.	$5,313.36
Total		$56,013.36 interest

120. Simple interest computed at the rate of 8% on accounting and attorney fees paid by the District for Patrick's personal matters from June 30, 1975 to June 30, 1979 amounts to $1,428.

Conclusions of Law

From the foregoing facts, the Court adopts the following conclusions of Law:

1. This Court has jurisdiction of this action under Section 22(a) of the Securities Act of 1933, as amended *(15 U.S.C. 77v*[a] and Section 27 of the Securities Exchange Act of 1934, as amended *(15 U.S.C. 78aa),* and it has in personam jurisdiction of the defendants.

2. Defendant Patrick has violated the antifraud provisions of the Federal Securities Laws, namely Section 17(a) of the Securities Act of 1933 *(15 U.S.C. 77q*[a]0 and Section 10(b) of the Securities Exchange Act of 1934 *(15 U.S.C. 78j*[b]) and Rule 10(b)5 promulgated thereunder (17 C.F.R. 240.10b-5). As part of his scheme all bond resolutions, bond certificates, and bond offering circulars misrepresented or failed to disclose:

(1) The payments made by Diversified to HPO (Patrick) of half of the fiscal agent's fees;

(2) Commissions paid to HPO (Patrick) on the sale of equipment to the District;

(3) Excessive fiscal agent's fees paid by the District;

(4) Loans and other payments by the District to Patrick and relatives or entities controlled by them;

(5) That accurate books and records were not maintained as required by the bond resolutions;

(6) That the District failed to have audited financial statements as required by the bond resolutions and state law;

(7) Excessive discounts given on the sale of the bonds;

(8) The purchase by the District from Patrick of an option to purchase land;

(9) That Patrick and not the Board of Commissioners controlled the District;

3. A duty to disclose material information arises when a person possessing that information has direct contact with investors. Such direct contact does not require physical presence or face-to-face conversation but is satisfied when an agent of an entity undertakes to transmit, for use of investors, information concerning that entity's securities or the entity itself. *Securities and Exchange Commission v. Coffey, 493 F.2d 1304 (6th Cir. 1974);* Securities and Exchange Commission v. Washington County Utility District, Case No. 80-1261, slip opinion, pp. 7-9.

4. The Securities Act "was intended to cover any fraudulent scheme in an offer or sale of securities, whether in the course of an initial distribution or in the course of ordinary market trading" *U.S. v. Naftalin, 99 S.Ct. 2077, 2084 (1979).*

5. The repeated and continuous securities offerings from 1969 through 1974 without complying with any of the promises and representations contained in the resolutions and the bonds; the disregard of State law; the active concealment of the financial condition of the District; the payment and concealment of fiscal agent's fees and other payments made in connection with the sales; and the self-dealing by Patrick, particularly the accepting of one-half of commissions from Alcock, sales of property and loans to himself and entities controlled by him, constitute a violation of the anti-fraud provisions of the Federal Securities Laws.

Securities and Exchange Commission v. Blatt, *583 F.2d 1325 (5th Cir. 1978);* Securities and Exchange Commission v. Commonwealth Chemicals Securities, Inc., *574 F.2d 90, 100 (2nd Cir. 1978).*

6. "Disgorgement is remedial" and forces the wrongdoer "to give up . . . the amount by which he was unjustly enriched. "Thus, the Court has the power "to order disgorgement . . . with interest" of the amount the person "profited from his wrongdoing."

Securities and Exchange Commission v. Blatt, supra at 1335.

7. Injunctive actions brought by the Securities and Exchange Commission are not governed by state statutes of limitations or laches.

United States v. Summerlin, *310 U.S. 414, 416 (1940)*; Costello v. United States, *365 U.S. 265, 281 (1961)* ; United States v. Kellum, *523 F.2d 1284, 1286 (5th Cir. 1975).*

8. Utility Districts are prohibited from paying interest over eight per cent.

Tennessee Code Annotated, Chapter 26, Sec. 6-2620

9. A final judgment of permanent injunction should be granted.

10. Disgorgement to prevent Patrick from being unjustly enriched and benefited should be ordered as follows:

A. One-half of the fiscal agent'sfee received from Alcock or Diversified

$96,604.27

B. Amount misappropriated by Patrick for payment to General Electric on behalf of D & P Development Company

10,000.00

C. Amount received by Patrick as commission on the sale of packers to the District

23,316.66

D. Amount credited to Patrick from the sale $15,000 face amount of the CATV Division's first issue of bonds to T.R. Alcock & Co. on April 26, 1973

10,500.00

E. Amount paid to J. B. Holt for accounting services in connection with the Internal Revenue Service audit of Patrick personally

1,250.00

F. Amounts misappropriated from the proceeds of the District's 1974 Garbage Division offering for payment of legal ($712.50) and accounting ($2,500) fees in connection with an Internal Revenue Service inquiry into the personal tax returns of Patrick and Alcock

3,212.50

11. In view of the fact that Patrick worked for the District, disgorgement of the salary received by Patrick will not be ordered; and because the District obtained the use of Patrick's property, disgorgement of the rental payments received by Patrick is, similarly, not ordered, nor the amounts paid on behalf of Eastern TV Cable Corp. or the proceeds obtained by Puckett from bonds given to him by Patrick because he, Patrick, did not get the use or benefit of such funds.

Table of Abbreviations

Alcock Tr.	Alcock Transcript
Carty Tr.	Carty Transcript
Ex.	Exhibit admitted at the pre-trial hearing
Glidden Tr.	Glidden Transcript
Lamberson Tr.	Lamberson Transcript
Michael Tr.	Michael Transcript
Patrick	Patrick Transcript
Prel. Ex.	Exhibit admitted at hearing on motion for Preliminary Injunction
Prel. Tr.	Transcript of testimony at hearing on motion for Preliminary Injunction

To Contents

SEC v. Reclamation District No. 2090, et al., Civ. Action No. C76-1231-

SAW (N.D. Cal.), Litigation Release No. 7460 (June 22, 1976) (complaint).

See "The Issuer" section.

To Contents

SEC v. Reclamation District No. 2090, et al., Litigation Release No. 7547 (September 2, 1976) (settled final order).

Gerald E. Boltz, Regional Administrator of the Los Angeles Regional Office, and Michael J. Stewart, Acting Associate Regional Administrator of the San Francisco Branch Office, announced that on August 27, 1976, the Honorable Robert H. Schnacke, United States District Judge for the Northern District of California, on motion of the Commission, entered an Order of Preliminary Injunction against James H. Dondich of Santa Ana, California, and Roy J. Jackson of Ogden, Utah, proscribing violations of the anti-fraud provisions of the federal securities laws in connection with offers and sales of securities issued by Reclamation District No. 2090 ("the District") and any other security of any other issuer.

Judge Schnacke also entered Final Judgments of Permanent Injunction against Max H. Mortensen of Oakland, California, All-States Tax Exempt Securities, Inc., and Pasquale "Pat" Tamburri, of Clearwater, Florida on August 18, 1976; against Norton McGiffin of Largo, Florida, George E. Grills of Dunedin, Florida, and Jules L. Steele of Clearwater, Florida, on August 16, 1976; against Robert D. Lewis of Palo Alto, California, and John B. Schoenfeld and Lowell C. Lundell of Atherton, California, on August 19, 1976; and against National Municipal Bond Co., Inc. and Roger W. Osness of St. George, Utah on August 24, 1976. The permanent injunctions enjoin these defendants from violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder in connection with offers and sales of any securities issued by the District and any other issuer. These defendants consented to the entry of the permanent injunctions without admitting or denying the allegations of the Commission's complaint.

The Commission's complaint alleged that the defendants' activities in violation of the anti-fraud provisions of the federal securities laws resulted in the sales of approximately $2.2 million of the notes issued by the District to approximately 161 persons residing in at least 12 states. Pursuant to Court approval, the Commission is also participating as a party in interest in a proceeding commenced by the District under Chapter IX of the Federal Bankruptcy Act. For further information, see Litigation Release No. 7460.

To Contents

Commission Orders - Settled Administrative Proceedings

In re City of Syracuse, New York, Warren D. Simpson, and Edward D. Polgreen, Securities Act Release No. 7460, Exchange Act Release No. 39149, AAE Release No. 970, A.P. File No. 3-9452 (September 30, 1997).

See "The Issuer" section.

To Contents

Obligated Persons

Report under Section 21(a) of the Exchange Act

SEC, Staff Report on Transactions in the Marine Protein Corporation Industrial Development Revenue Bonds, Exchange Act Release No. 15719 (April 11, 1979).

Introduction

The staff of the Division of Enforcement pursuant to a formal order of investigation authorized by the Commission on April 13, 1976, conducted a private investigation In the Matter of Marine Protein Corporation Industrial Development Revenue Bonds, Mammoth Spring, Arkansas. The Commission now makes this report of that investigation.[n1] This case is another in the series of investigations which focuses on abuses in connection with the issuance of IDR bonds.[n2] It focuses on, among other things: (1) the standards of disclosure required in an industrial revenue bond offering, and (2) the responsibility of the corporate lessee, the underwriter and the financial adviser to the issuer for full disclosure, in connection with the offer of industrial revenue bonds.

According to monthly statistical bulletins edited by the Public Securities Association, the number of tax exempt industrial development bond issues (excluding pollution control issues) since 1972 were: 1972 – 125 issues totaling $296 million; 1973 – 280 issues totaling $573 million; 1974 – 274 issues totaling $493 million; 1975 – 263 issues totaling $455 million; 1976 – 285 issues totaling $487 million; 1977 – January-May, 79 issues totaling $237 million.

The staff's inquiry principally focused on the period from January 1972 when the bond offering was conceived through 1976 when the bonds were declared to be in default. During the investigation, the staff obtained numerous documents and compiled 3,000 pages of transcribed investigative testimony. The staff's Report is a summary of the evidence that has been obtained to date. The Commission has decided to release this Report in the public interest pursuant to Section 21(a) of the Securities Exchange 1934. This is not to be construed as an adjudicative determination. Nor is the investigation or this Report a determination of the rights or liabilities of any person.

Background

This matter involves two successive efforts of a small, newly formed corporation, Marine Protein Corporation ("Marine") to raise financing for the establishment of facilities for Marine's operations. During 1972 the company raised $3.5 million through the offering of common stock to the public. This offering was registered with the Commission pursuant to the Securities Act of 1933. Later in 1972, through an offering of industrial

development revenue bonds that were sold pursuant to a claimed exemption from registration with the Commission (pursuant to Section 3(a)(2) of the Securities Act), Marine raised an additional $2.5 million. The striking contrast between the disclosure of material matters contained in the prospectus utilized for the offering of common stock registered with the Commission and the material omissions contained in the offering circular used to promote the sale of the industrial development revenue bonds makes it clear that the participants in the bond underwriting failed to comply with the standards of disclosure that are required by the antifraud provisions in connection with the offering and sale of any securities. The information gathered in the Commission's investigation, demonstrates that Marine fell short of its obligation to public investors by failing to assure that the information being disseminated to the public in connection with the sale of the industrial development revenue bonds was adequate, accurate and consistent with the information it had provided to the bond underwriters.

Marine is a Delaware corporation with headquarters formerly in New York City. The company was incorporated in 1969 and its primary business venture was to perfect a method to breed fish under environmentally controlled, high density conditions (Silo Fish Farms) for ultimate commercial sale. The controlling persons of the company which comprised its executive-managerial staff possessed varied business backgrounds unrelated to the fish industry and Marine's claimed advance research and development relating to the commercial growth of fish was based upon the invention principally of one marine biologist whose theories had never been tested beyond two pilot programs.

At its inception in 1969-1970 the company raised approximately $2.5 million through private placements of securities. In February 1972, the company raised $3.5 million through a public offering of securities registered with the Commission pursuant to the Securities Act of 1933. Prior to Marine's public offering, its activities had been limited to research and development at a pilot facility in Pennsylvania. The proceeds from the sale of the common stock were to be used primarily to begin construction of a trout farm in Mammoth Spring, Arkansas. Because the company was using a completely new technique for raising fish which had not yet been proven commercially feasible, the Commission's Division of Corporation Finance required Marine to make full disclosure of the risks involved in the purchase by investors. Marine's registration statement and prospectus ("stock prospectus") enumerated certain risk factors which prospective investors were warned to "carefully consider". Disclosure of these risk factors and other statements about the company's processes followed closely those disclosures which were included previously by the company in its private placement memoranda that was utilized to raise financing for the company's 1969-70 placement of securities referred to above.

Sale of Industrial Development Revenue Bonds

On May 16, 1972, some three months following issuance of the registered common stock, the City of Mammoth Spring, Arkansas, held a special election for the purpose of authorizing a total of $4 million of Industrial Development Revenue Bonds for the benefit of Marine. On the advice of the bond underwriter, it initially was decided that bonds in the amount of $2.5 million would be offered to the public and that the remaining $1.5 million would be sold whenever Marine requested it. On October 6, 1972, Marine

announced to its shareholders the signing of an agreement with the bond underwriter for the sale of $2.5 million of 26-year maturity industrial revenue bonds. This underwriter purchased the bonds from the City of Mammoth Spring, Arkansas, on December 1, 1977, at a discount price of 91 and wholesaled the bonds at 97 to the now defunct municipal bond broker-dealer, Seaney Jones & Co. of Atlanta, Georgia, ("Seaney"). Seaney sold most of the bonds to Paragon Securities of New Jersey ("Paragon") at 99.[n3] Paragon retailed most of the issue to individual investors all over the United States at premium prices as high as 116. The bond underwriter had characterized the issue as "speculative" to its trading desk and elected not to allow its trading desk to make retail sales of the bonds to their own customers. This underwriter's role in the offering was that of structuring the issue and preparing the "offering prospectus." For its efforts, the underwriter collected a fee of $142,500 or the difference between purchasing the bonds at 91 from the issuing authority and selling them to Seaney at 97.

The "offering prospectus" was prepared in-house by the bond underwriter's staff and was given to Seaney, Paragon and another bond house in New York that retailed a small percentage of the bonds. The finished document was used by Paragon to prepare a brief two-page summary of the offering which included pertinent facts about the bonds including: Denominations; Date; Interest; Security; Bond Counsel; Marine net worth, etc. Paragon disseminated this information sheet to its retail customers.

The "offering prospectus" was prepared only some eight months after the company's common stock offering. Material about Marine and its operational plans and projections was copied from advertising brochures, news articles and the 1972 Annual Report to Shareholders which had previously been furnished to the underwriter by Marine. In addition to this material, Marine also provided the bond underwriter with a copy of the common stock prospectus. The bond concerning the risks of fish farming or the risks involved in investing in Marine (discussed more fully under "Comparison of Disclosure") that were contained in the common stock prospectus. The bond prospectus did contain misleading bullish information as described below but failed to include disclosures concerning the use of the proceeds of the bond offering. The bond offering prospectus also included excerpts from the bond indenture.

Events Subsequent to Bond Sale

Marine's commercial application of its silo system from research laboratory to its anticipated production site at Mammoth Spring, Arkansas, experienced a variety of problems which over a two-year period contributed to the ultimate collapse of the company. From the date of the bond closing on December 1, 1972, the company had a 10-month grace period in which to complete its major facility in Arkansas and begin marketing fish because first payments for principal on the bonds became due on October 1, 1974. Site preparation at Mammoth Spring began in June 1972 which was several months before the bond financing was obtained. The bond money enabled the company to develop its site in a more grandiose style with the immediate installation of 36 silos and plans for an additional 36 silos if the first set proved the process to be a commercial success. A combination of natural disasters and faulty planning delayed completion of the facility by over seven months.

By October 1973, the first set of 36 silo tanks was in place. But, even at this time, the system was far from final working order. The first harvest, which was smaller than anticipated, did not begin until late February 1974. When the fish were ready for harvesting, the company did not have adequate facilities at the site to dress, package, freeze and ship the product to established markets. Therefore, excessive costs were incurred because the fish had to be air freighted to New York from Arkansas. This requirement diminished whatever advantages the company hoped to obtain through use of the silo systems.

Marine's indebtedness continued to increase and on January 20, 1976, the trustee for bondholders filed a complaint in Arkansas federal court asking that the court decree Marine in default on the bonds. The court appointed a receiver to take custody and control over Marine's only real asset – the silo farm at Mammoth Spring, Arkansas.

Comparison of Disclosure

The disclosures of information contained in the bond prospectus differ significantly from and in some respects are inconsistent with the disclosures in the common stock prospectus. Risk factors and other Important information relating to the speculative nature of an investment in Marine that were included in the common stock prospectus are absent from the bond "offering prospectus" and that document contains considerable bullish promotional information that is inappropriate in a prospectus used to sell securities. A comparison of some of these matters follows:

(1) Fish Production – The bond prospectus states that Marine "has developed one of the most important breakthroughs in fish production since the ancient Chinese" and that "Marine is able to produce over 3,000 times as many pounds of fish in the same surface area as a farmer can raise in a fish pond. "It also states that "A Marine Protein Silo Fish Farm is capable of producing 1,000,000 pounds of fish per surface area per year, even after deducting space for road and equipment."

In fact, these figures were mere estimates which were predicted by the company's scientists based on a pilot project, and were never the result of actual silo production. The common stock prospectus states that "Because of the variety of circumstances under which fish were grown, the Company is unable to state the length of time it takes fish to grow in their natural environment or to be farmed and harvested by conventional means."

(2) Advantages of the Silo System – The bond prospectus states 11 advantages of Marine's silo system as compared to conventional systems. There is no mention of these advantages in the common stock prospectus. The advantages cited include location, non-pollution, predator control, healthy fish, economy in feeding, fast growth, uniform fish sizes, year-round availability, harvesting economy, processing savings and brood stock and spawning.

In fact, Marine's own scientists did not regard these advantages to be particularly unique to the silo system. The same results were achieved by fish farmers using conventional raceway techniques.

(3) Fast Growth/Uniform Fish Sizes – The bond offering prospectus emphasizes particularly the silo's advantage in achieving fast growth and uniform sizes in fish.

As stated under #1 above, scientists are unable to compare fish growth under natural and under artificial conditions with any degree of accuracy.

(4) Harvesting Economy/Processing Savings – The bond prospectus states that Marine's larger harvests are economical because fish can be easily transferred to the "Marine processing plant "Also, it is stated that "Large production facilities make it economically feasible to locate processing plants adjacent to Marine Protein Silo Fish Farms."

In fact, the company never had the type of processing facilities alluded to in the bond prospectus although they had plans for the development. The common stock prospectus does state the company's intention to erect a processing plant in Mammoth Spring but also states with respect to "the commercial feasibility of its operations" that "it is not certain, however, that such processing plants will function according to plan."

(5) Fish Mortality – The bond offering prospectus states that conventional fish rearing systems suffer from considerable mortality because of imposed environmental stresses and that Marine's silo system protects fish from their natural enemies and the stresses of intensive fish culture are reduced to a minimum.

In fact, early tests did not prove that the system could limit the environmental stresses. Moreover, the common stock prospectus specifically stated that Marine's fish are not immune from disease, and their main research facility had experienced losses of fish resulting from temperature changes and poor water quality.

(6) Silo Farm Location – The bond prospectus boasted that the silo system was capable of being installed close to major markets thereby reducing excessive transportation costs.

In fact, the silo system, much like the traditional systems, still depended upon a sufficient supply of water of adequate quality which naturally limited the potential location to land areas where such water is available. As is stated in the common stock prospectus: "The water supply at any existing or future site must be of adequate quality and is always subject to the danger of drought and pollution."

Conclusion

The process by which industrial development revenue bonds are brought to the market place depends upon many persons, including the issuer, underwriter, fiscal agents, bond counsel, company executives and registered representatives. The antifraud provisions of the federal securities laws, while not imposing a structured form of disclosure as required for the offering of non-exempt securities pursuant to the Securities Act of 1933, do prohibit the deception of investors in connection with the offering of exempt securities. In preparing and disseminating the bond offering prospectus, the bond underwriter failed to include the material information referred to

above, and Marine failed to accept or assume any responsibility to insure that information being disseminated by bond underwriters in connection with the bond offering was complete and not false and misleading.

Statement of Commissioner Karmel

Commissioner Karmel, dissenting

I object to the issuance of this staff report because, as more fully explained in my dissent In the Matter of Spartek, Inc.,[n4] and my separate statement to the Commission's recent announcement relating to reports of investigations,[n5] I do not believe that publication based on Section 21(a) of the Securities Exchange Act of 1934 should be used as a sanction to dispose of investigated matters.

Footnotes

-[n1]-Commissioner Karmel dissented from this determination of the Commission for the reasons set forth in her statement which follows this release.

-[n2]-Industrial Development Revenue Bonds are popular financing vehicles because they are used by municipalities to attract new industry to their area. The proceeds of these industrial development revenue bonds are used by the issuing municipality to erect an industrial facility which is then leased to a private corporation for business use. The principal and interest on the bond issue is paid only from the revenues of the private corporation.

-[n3]-As the result of a civil injunctive action brought by the Commission, Paragon and its principals were enjoined by consent from further violations of the antifraud provisions of the federal securities laws. (Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act of 1934 and Rule 10b-5 thereunder.) Paragon is no longer in business.

-[n4]-Securities Exchange Act Release No. 15567 (February 14, 1979).

-[n5]-Securities Exchange Act Release No. 15664 (March 21, 1979).

To Contents

Injunctive Proceedings

Securities and Exchange Commission v. Lee F. Sutliffe, Civ. Action No. 95-0867-CV-W-BD (W.D. Mo.), Litigation Release No. 14658 (September 28, 1995) (complaint).

The Securities and Exchange Commission today announced the filing of a Complaint on September 27, 1995, in the United States District Court for the Western District of Missouri, in Kansas City, seeking an order of permanent injunction against Lee F. Sutliffe (Sutliffe). The Commission's Complaint alleges that Sutliffe, by participating in the preparation of false and misleading municipal bond offering circulars, violated the antifraud

provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934.

The Complaint alleges, among other things, that during the years 1984 through 1989, Sutliffe was the undisclosed promoter and control person of two not-for-profit corporations, First Humanics Corp. (First Humanics) and its successor, International Elderly Care, Inc. (IEC), which participated in 26 public offerings of municipal and corporate bonds raising over $107 million. The purpose of these offerings was to acquire, renovate and operate nursing homes.

The Complaint further alleges that, in connection with two such offerings, First Humanics' 1987 offering to acquire the Medicos Recovery Care Center nursing home in Detroit, Michigan (Medicos) and IEC's 1988 offering to acquire the Colonial Gardens Convalescent Center in Boonville, Missouri (Colonial Gardens), Sutliffe promoted the offerings and participated in the preparation of false and misleading offering circulars. Specifically, the Complaint alleges that the Medicos offering circular contained material misrepresentations and omissions concerning: Sutliffe's role as a promoter of the offering; Sutliffe's control over First Humanics as well as his regulatory history and numerous prior bond and business failures; the commingling of revenues from existing First Humanics nursing homes and the resulting financial interdependence of all First Humanics nursing homes; and First Humanics' ongoing ponzi scheme.

In addition, the Complaint alleges that the Colonial Gardens offering circular contained material misrepresentations and omissions concerning: Sutliffe's role in the offering and his control over IEC as well as his background; the nexus between IEC and First Humanics; and First Humanics' prior bond defaults.

To Contents

Securities and Exchange Commission v. Lee F. Sutliffe, Litigation Release No. 14707 (November 1, 1995) (settled final order).

The Securities and Exchange Commission today announced that on October 27, 1995 the United States District Court for the Western District of Missouri, in Kansas City, entered an Order of Permanent Injunction (Order) against Lee F. Sutliffe (Sutliffe). The Order enjoins Sutliffe from future violations of Sections 17(a)(1), 17(a)(2) and 17(a)(3) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Sutliffe consented to the entry of the Order without admitting or denying the allegations in the Commission's Complaint.

The Commission's Complaint, filed on September 27, 1995, alleged, among other things, that during the years 1984 through 1989, Sutliffe was the undisclosed promoter and control person of two not-for-profit corporations, First Humanics Corp. (First Humanics) and its successor, International Elderly Care, Inc. (IEC), which participated in 26 public offerings of municipal and corporate bonds raising over $107 million. The purpose of these offerings was to acquire, renovate and operate nursing homes.

The Complaint further alleged that, in connection with two such offerings, First Humanics' 1987 offering to acquire the Medicos Recovery Care Center nursing home in Detroit, Michigan (Medicos) and IEC's 1988 offering to acquire the Colonial Gardens Convalescent Center in Boonville, Missouri (Colonial Gardens), Sutliffe promoted the offerings and participated in the preparation of false and misleading offering circulars. Specifically, the Complaint alleged that the Medicos offering circular contained material misrepresentations and omissions concerning: Sutliffe's role as a promoter of the offering; Sutliffe's control over First Humanics as well as his regulatory history and numerous prior bond and business failures; the commingling of revenues from existing First Humanics nursing homes and the resulting financial interdependence of all First Humanics nursing homes; and First Humanics' ongoing ponzi scheme.

In addition, the Complaint alleged that the Colonial Gardens offering circular contained material misrepresentations and omissions concerning: Sutliffe's role in the offering and his control over IEC as well as his background; the nexus between IEC and First Humanics; and First Humanics' prior bond defaults.

To Contents

SEC v. Calhoun County Medical Facility, Inc., et al., Civ. Action No. WC-81-61 WK-P (N.D. Miss.), Litigation Release No. 9366 (June 1, 1981) (settled final order).

Jule B. Greene, Regional Administrator of the Commission's Atlanta Regional Office, announced the filing of a Complaint, alleging violations of Sections 17(a)(2) and (3) of the Securities Act of 1933 against Calhoun County Medical Facility, Inc. ("the Issuer"), a Mississippi corporation; Bullington-Schas & Co., Inc. ("Bullington-Schas"), a Memphis, Tennessee broker-dealer; A. Dulaney Tipton ("Tipton") of Memphis, Tennessee, President of Bullington-Schas; Terry Allen Frost ("Frost") of Memphis, Tennessee, a registered representative associated with Bullington-Schas; and Jerald H. Sklar ("Sklar"), an attorney in Memphis, Tennessee.

The Commission's Complaint alleged that the Issuer offered and sold $1.8 million of its first mortgage revenue bonds to finance the acquisition of the Calhoun County Hospital in Calhoun County, Mississippi; that Bullington-Schas served as underwriter for the bond issue; that Tipton and Frost performed Bullington-Schas' underwriting duties and participated in the sale of the bonds; and that Sklar acted as bond counsel. The Complaint further alleges that annual financial statements concerning the past operations of the Hospital, which indicated an inability to defease the bond offering, were not included in the offering circular; rather, pro forma financials were included without discussion of the significantly divergent prior financial history.

The Commission's Complaint further alleged that defendants made untrue statements and omitted to state material facts concerning, among other things, the role, duties and responsibilities of counsel to the underwriter and bond counsel.

On May 28, 1981, the Honorable William C. Keady, Chief Judge of the

United States District Court for the Northern District of Mississippi, entered final judgments permanently enjoining the defendants from further violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act. The defendants consented to the relief without admitting or denying the allegations of the Commission's Complaint. Defendant Sklar was ordered also to comply with the undertakings contained in his Stipulation and Consent concerning procedures to be followed in connection with future bond issues.

For further information concerning (i) a related administrative proceeding involving Bullington-Schas, Tipton and Frost, see Securities Exchange Act Release No. 17832; and (ii) a Section 21(a) Report involving the role of underwriter's counsel, see Securities Exchange Act Release No. 17831.

To Contents

SEC v. San Antonio Municipal Utility District No. 1, et al., Civ. Action No. H-77-1868 (S.D. Tex.), Litigation Release No. 8195 (November 18, 1977) (settled final order).

See "The Issuer" section.

To Contents

SEC v. Astro Products of Kansas, Inc., et al., Civ. Action No. 76-359-LG (D. C. Kans.), Litigation Release No. 7557 (September 13, 1976) (complaint).

Richard M. Hewitt, Administrator of the Fort Worth Regional Office of the Securities and Exchange Commission, announced today the filing on August 31, 1976 of a civil injunctive complaint in federal district court at Wichita, Kansas naming 19 corporate and individual defendants. The complaint charged violation of the securities registration and antifraud provisions of the federal securities laws and the Trust Indenture Act in connection with the offer and sale of industrial development revenue bonds issued by Astro Products of Kansas, Inc., Haysville, Kansas, and the City of Haysville.

The defendants were charged with violations of the following provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and the Trust Indenture Act of 1939:

Astro Products of Kansas, Inc., Los Angeles, California – antifraud; securities registration; trust indenture qualification.

Canter Line Tool Company, Inc., Los Angeles, California – antifraud.

The Vern Hunt Co., Los Angeles, California – antifraud.

The National Bank of Wichita, Wichita, Kansas – antifraud.

Sima Walding Supply Co., Inc., Los Angeles, California – antifraud.

Tower Brokerage, Inc., St. Petersburg, Florida – antifraud.

Hugh Bell, St. Petersburg, Florida – antifraud.

Bruce Bressman, Los Angeles, California – antifraud.

Roman A. Dimeo, Los Angeles, California – antifraud, securities registration; trust indenture qualifications.

Theodore F. Dubowik, Memphis, Tennessee – antifraud.

George B. Flowers, Los Angeles, California – antifraud.

Richard T. Heagy, Memphis, Tennessee – antifraud.

Vern Hunt, Los Angeles, California – antifraud.

Herbert M. Kohn, Kansas City, Missouri – antifraud; securities registration; trust indenture qualification.

Stephen A. Lancaster, Memphis, Tennessee – antifraud.

Ray W. Lipper, Los Angeles, California – antifraud.

James J. Russ, Memphis, Tennessee – antifraud; securities registration; trust indenture qualification.

Walter A. Sawhill, Wichita, Kansas – antifraud; securities registration; trust indenture qualification.

M. Kelley Sims, Los Angeles, California – antifraud.

The complaint charged the defendants with a scheme to violate the federal securities laws. The Commission alleged in the complaint that James J. Russ, Roman A. Dimeo and Walter A. Sawhill engaged in a scheme to promote an industrial development revenue project in Haysville, Kansas. The alleged scheme involved procuring the issuance by the City of Haysville of $2,200,000 industrial development revenue bonds of which the proceeds were to be used to acquire equipment for a plant to assemble vehicular wheel. As part of the alleged scheme, Russ misrepresented his background and the economic potential to Haysville of the proposed assembling plant and bond counsel, Herbert A. Kohn, by furnishing an opinion that the bonds were duty authorized made it possible for the issue to be marketed and issued and tax exempt.

Further, the complaint charged that following the issuance of the bonds, Russ, Dimeo and Sawhill arranged for the bonds to be sold to several underwriters, including Richard T. Heagy, Stephon A. Lancaster, Theodore F. Dubowik and Hugh Bell. The complaint further alleged that these underwriters than sold the bonds through misrepresentation to various broker-dealers, including Bruce Bressman, who ultimately sold the bonds to the public. In selling the bonds, the underwriters, relying ostensibly upon unverified information supplied by Russ, and without exercising due

diligence, misrepresented;

(1) The security behind the investment;

(2) The financial condition of the corporate issuer;

(3) The use of the project's proceeds;

(4) The background of those involved in the project;

(5) The likelihood of success for the project;

(6) The lead time necessary for beginning operations; and

(7) The tax exempt status of the bonds; and omitted to state:

(1) The high risk nature of the investment;

(2) The diversion of the project's proceeds; and

(3) The lack of security available to the bondholders.

Approximately $400,000 of the issue was sold to public investors and approximately $1,800,000 was used as part of an alleged scheme to defraud the First Federal Savings and Loan, Utica, New York.

During and after the issuance of the bonds (which were issued in five increments between December 21, 1973 and May 6, 1974), Russ and Dimeo allegedly in a scheme to misappropriate proceeds of the issue, or approximately $1,700,000, with four of the project's equipment suppliers, Ray W. Lipper, Center Line Tool Company, Inc., M. Kelley Sims, Sims Walding Supply Company, Vern Hunt, Vern Hunt Company, and George Flowers. The complaint alleges that each of these suppliers had done business with defendant Russ prior to the Haysville project and that through the suppliers submission of false invoices, many of which were allegedly prepared by or at the direction of Russ, in excess of $800,000 of the proceeds were diverted through fraud from the project.

According to the complaint this fraud was made possible because Haysville and the National Bank of Wichita, the fiscal agent, violated express duties which they had agreed to perform for the protection of the bondholders. The complaint charged that these breaches of duty occurred, in part, because Kohn gave incorrect advice to officials of both Haysville and the fiscal agent concerning their duties. In addition to this alleged scheme involving the four suppliers and their companies, Russ allegedly submitted a number of purportedly false and forged invoices to the National Bank of Wichita for which he paid over $200,000.

The complaint states that the project never began operation. Over a year and a half after the last closing in May 1974, a committee of the bondholders assumed control over the project and liquidated it. The liquidation value of the bonds has been set at $.037 on the dollar. The bondholders' committee is now distributing the liquidated proceeds to the

bondholders.

To Contents

SEC v. Astro Products of Kansas, Inc., et al., Litigation Release No. 7774 (February 10, 1977) (settled final orders).

Richard M. Hewitt, Administrator of the Fort Worth Regional Office of the Securities and Exchange Commission, announced today that on January 19, 1977, Federal District Judge Frank G. Theis of Wichita, Kansas, granted the Commission's motion for preliminary injunction enjoining defendants Tower Brokerage, Inc.; Hugh Bell, both of St. Petersburg, Florida; Richard T. Heagy of Memphis, Tennessee; and Theodore DuBowik of Phoenix, Arizona, from future violations of the anti-fraud provisions of the federal securities laws. Judge Theis also granted the Commission's motion for preliminary injunction against Roman A. DiMeo of Santa Ana, California, enjoining him from future violations of the registration, anti-fraud, and trust indenture qualification provisions of the federal securities laws.

On January 18, 1977, Judge Theis issued a default order preliminary enjoining defendants Vern Hunt and the Vern Hunt Company, both of West Covina, California, from future violations of the anti-fraud provisions of the federal securities laws.

On November 29, 1976, defendants James J. Russ and Astro Products of Kansas, Inc., both of Memphis, Tennessee, consented, without admitting or denying the Commission's allegations, to the entry of a permanent injunction enjoining them from future violations of the registration, anti-fraud, and trust indenture qualification provisions of the federal securities laws. For further information, see Litigation Release No. 7557.

To Contents

SEC v. Astro Products of Kansas, Inc., et al., Litigation Release No. 8613 (December 8, 1978) (defaults entered).

Michael J. Stewart, Administrator of the Fort Worth Regional Office, announced that on October 31, 1978, Federal District Judge Frank Theis, chief judge for the District of Kansas at Wichita, entered orders of permanent injunction by default against Theodore F. DuBowik, Phoenix, Arizona; Vern Hunt, and The Vern Hunt Company, both of Los Angeles, California. These orders enjoin the defendants from future violations of the anti-fraud provisions of the securities laws. For further information, see Litigation Release No. 8574.

To Contents

SEC v. The Senex Corporation, et al., Civ. Action No. 74-53 (E.D. Ky.), Litigation Release No. 6451 (July 24, 1974) (complaint).

The Securities and Exchange Commission today announced the filing of a

complaint in the U.S. District Court for the Eastern District of Kentucky seeking a preliminary and permanent injunction against The Senex Corporation, a Delaware corporation; Arthur Jay Tarley, Wyoming, Ohio; Mentor Corporation, a Kentucky corporation; A.J. Jolly, Alexandria, Kentucky; Alison, Jay, Malcolm & Company (formerly known as Stemac Management Corporation), a Delaware corporation; BFT, Inc., an Ohio corporation; and Thomas N. Street, Jr., Memphis, Tennessee, from engaging in further violations of certain anti-fraud provisions of the federal securities laws [Section 17(a) of the Securities Act of 1933 and Section 10 (b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder] in connection with the offer and sale of certain municipal revenue bonds.

The Commission's complaint alleges that the defendants engaged in a fraudulent scheme pursuant to which they promoted with officials of the City of Covington, Kentucky, the concept of building in Covington a nursing home to house the indigent, the infirm and the elderly and that they induced the City of Covington, Kentucky, to authorize the issuance of $4,415,000 City of Covington Health Care Project Revenue Bonds to provide funds to finance the construction of the proposed nursing home.

The complaint alleges that the defendants caused a corporation controlled by certain of the defendants to be appointed to construct the facility for a contract price of approximately $2.9 million and subsequently entered into a contract with a local contractor to construct the same facility for approximately $2.3 million; that when a question arose as to the need for such a facility in the Covington area, the defendants convinced City officials of the need for and the feasibility of the project by withholding and/or endeavoring to discredit two contemporaneous studies which reflected adversely on the need for such a nursing home in the Covington area. In this connection, the complaint alleged that the defendants refused to make available to the Northern Kentucky Health and Welfare Planning Council a copy of an adverse feasibility report stating that the report was "the private domain of the underwriter" when in fact no such underwriter was in existence at that time; and that certain of the defendants stated that the best indication of the project's feasibility was that a sophisticated investment banker was willing and anxious to invest in excess of $4,000,000 in the project when in fact that statement was untrue, and the defendants had been unable to locate any independent securities dealer to underwrite the proposed bond issue.

The complaint alleges that as a further part of the scheme, the defendants caused a purportedly independent feasibility consultant to render a report bearing favorably on the feasibility of the project when in fact the feasibility consultant was not independent but was a promoter and a developer of the nursing home project who expected to share in the developer's profits; and further that the defendants caused a broker-dealer controlled by certain of the defendants to be appointed as financial adviser for the project and as underwriter of the bond issue.

The complaint further alleges that as a further part of the scheme, an offering prospectus was prepared and distributed to investors which failed to disclose, among others, the above material facts, and that the misleading prospectus was used by the defendants in securing an "A" rating for the bonds, which rating was used along with the prospectus to facilitate the sale of the bonds to other dealers and ultimately to individual investors.

To Contents

SEC v. The Senex Corporation, et al., Litigation Release No. 6769 (March 5, 1975) (settled final orders.)

The Securities and Exchange Commission announced the entry on March 3, 1975, of an order of preliminary injunction in the U.S. District Court for the Eastern District of Kentucky against A.J. Jolly, Mentor Corp. and Thomas N. Street, Jr. enjoining them from engaging in further violations of certain of the antifraud provisions of the federal securities laws (Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder) in connection with the offer, sale or purchase of City of Covington Health Care Project Revenue Bonds, Series 1972, or any other securities.

After an eleven day hearing on the Commission's motion for preliminary injunction, the Court in its opinion found that in connection with a new offering of municipal bonds issued to finance the construction of a health care facility in Covington, Kentucky, the defendants violated the antifraud provisions by, among other things, failing to disclose: (1) that the defendant Mentor Corporation which issued a consultant's report demonstrating the desirability of the proposed project would share in 50 percent of the developer's profit; (2) that there was a difference of opinion among experts concerning the need for the proposed project as evidenced by the existence of other feasibility reports bearing adversely on the proposed project; and (3) that the project's financial adviser and underwriter were owned and controlled by the developer.

The Court stated in its opinion that "Notwithstanding his biased position, Jolly prepared and permitted use of the Mentor report in the prospectus and as part of a 'package' designed to impress securities dealers" and that "At no time during the lengthy period involved in the promotion did the defendants make any effort to afford an accurate depiction of the experts' disagreements or the financial entanglement among involved entities."

Previously, Judgments of Permanent Injunction in this matter were entered by the U.S. District Court for the Eastern District of Kentucky against The Senex Corporation, Arthur Jay Tarley, Alison, Jay, Malcolm & Company formerly known as Stemac Management Corporation, and BFT, Inc., permanently enjoining them from further violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 in connection with the offer, sale or purchase of City of Covington Health Care Project Revenue Bonds, Series 1972 or any other securities. These defendants consented to the entry of permanent injunctions without admitting or denying the allegations of the Commission's complaint.

To Contents

SEC v. The Senex Corporation, et al., Litigation Release No. 8651 (January 23, 1979) (settled final orders).

The Securities and Exchange Commission announced the entry on December 5, 1978, of a Judgment of Permanent Injunction upon consent in the United States District Court for the Eastern District of Kentucky against A J Jolly, and Mentor Corporation, enjoining them from engaging in further violations of certain of the anti-fraud provisions of the federal securities laws (Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder) in connection with the offer, sale or purchase of CITY OF COVINGTON HEALTH CARE PROJECT REVENUE BONDS, SERIES 1972, or any other securities.

The Commission charged that in connection with a new offering of municipal bonds in 1972 issued to finance the construction of a health care facility in Covington, Kentucky, the defendants violated the anti-fraud provisions by, among other things, failing to disclose: (1) that the defendant Mentor Corporation which issued a consultant's report demonstrating the desirability of the proposed project would share in 50 percent of the developer's profit; (2) that there was a difference of opinion among experts concerning the need for the proposed project as evidenced by the existence of other feasibility reports bearing adversely on the proposed project; and (3) that the project's financial adviser and underwriter were owned and controlled by the developer.

Previously, Judgments of Permanent Injunction in this matter were entered by the United States District Court for the Eastern District of Kentucky against Thomas N. Street, The Senex Corporation, Arthur Jay Tarley, Alison, Jay Malcolm & Company formerly known as Stemac Management Corporation, and BFT, Inc., permanently enjoining them from further violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 in connection with the offer, sale or purchase of CITY OF COVINGTON HEALTH CARE PROJECT REVENUE BONDS, SERIES 1972 or any other securities. All defendants consented to the entry of permanent injunctions without admitting or denying the allegations of the Commission's complaint.

To Contents

SEC v. The Senex Corporation, et al., 399 F. Supp. 497 (E.D. Ky. 1975).

See Federal Reporter.

To Contents

Commission Orders - Settled Administrative Proceedings

In re Joseph LeGrotte, Securities Act Release No. 7200, Exchange Act Release No. 36036, A.P. File No. 3-8763 (July 31, 1995).

I. The Commission deems it appropriate and in the public interest that public administrative proceedings be instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Joseph LeGrotte ("LeGrotte").

In anticipation of the institution of these administrative proceedings, LeGrotte has submitted an Offer of Settlement which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceeding brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to jurisdiction, which is admitted, LeGrotte consents to the entry of this Order Instituting Proceedings pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Making Findings and Imposing a Cease and Desist Order.

Accordingly, it is ordered that proceedings pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act be, and hereby are, instituted.

II. On the basis of this Order and the Offer of Settlement submitted by LeGrotte, the Commission makes the following findings:

ENTITY INVOLVED

A. First Humanics Corp. ("First Humanics" or "the company"), a not-for-profit corporation, was in the business of acquiring, renovating and operating nursing homes. From 1984 through 1989, First Humanics renovated and operated 21 nursing homes acquired through 21 separate offerings totalling approximately $82 million in publicly sold municipal and corporate bonds. On October 15, 1987, the Economic Development Corporation of the City of Detroit, Michigan, for the benefit of First Humanics, acquired the Medicos Recovery Care Center (Medicos) through the issuance of $6,955,000 in tax-exempt bonds. This was First Humanics' last offering.

RESPONDENT

B. LeGrotte was an officer and director of First Humanics from 1986 to 1988. LeGrotte reviewed and signed the Medicos offering circular, participated in earlier First Humanics offerings and bond closings and was involved in the operations of First Humanics.

BACKGROUND

C. In connection with each offering, First Humanics contracted to purchase a particular nursing home. To finance the purchase, the Company arranged for a municipality to issue tax free municipal bonds. However, the Company remained liable for all payments to bondholders. To finance the issuance costs on certain of the above offerings, the Company, in some instances, also issued a modest amount of corporate bonds in conjunction with the tax exempt bonds. Again, the Company was liable for all payments to bondholders.

D. Each prospective nursing home was initially located by Lee F. Sutliffe ("Sutliffe"), the undisclosed control person of First Humanics and the undisclosed promoter of' First Humanics' offerings. If Sutliffe decided the nursing home was acceptable for acquisition, the First Humanics Board of Directors then voted to acquire the facility. Sutliffe received an acquisition fee of between $100,000 and $300,000 in connection with each nursing

home purchased by First Humanics.

E. Subsequent to the Board's approval, Sutliffe initiated the offering process, through which First Humanics obtained the funds necessary to purchase the nursing home. In connection therewith, Sutliffe assembled an offering "working group" which coordinated the offering process and was responsible for preparing the offering circulars. The activities of the First Humanics working group were largely directed by Sutliffe. In this manner, Sutliffe acted as the promoter of the offerings. LeGrotte also sometimes participated in working group meetings and reviewed offering materials prepared by the working group.

F. In connection with each offering, an offering circular was prepared. The offering circular typically contained sections describing First Humanics, the nursing home to be acquired, the bonds, sources and uses of bond proceeds, risk factors and, as appendices, a financial feasibility study and the Company's audited financial statements. The primary purpose of the offering circular was to provide the investing public with all material facts pertaining to the offering. LeGrotte reviewed offering circular drafts and executed numerous supporting documents which were used in connection with the drafting of the offering circular. In some instances, LeGrotte also signed the offering circulars on behalf of First Humanics. Thus, he participated in the preparation of the offering circulars.

G. Upon completion of the offering process, Sutliffe coordinated the bond closings. In connection therewith, Sutliffe prepared closing documents and directed the wiring and disbursement of bond proceeds from which were paid most of the issuance costs. At each bond closing, the municipal issuer sold the bonds to an underwriter who, in turn, resold them to the investing public through various retail broker-dealers. Upon receiving the bond proceeds from the underwriter, the municipal issuer either lent such proceeds to First Humanics so that the Company could purchase the nursing home, or the issuer purchased the nursing home and leased it back to the Company. A certain amount of bond proceeds were also set aside as working capital for the benefit of First Humanics.

H. Immediately after closing, First Humanics assumed the municipal issuer's repayment obligation to the bondholders. Thereafter, the Company was required to make monthly bond payments to the indenture trustee sufficient for the trustee to meet semi-annual interest payments to the bondholders. At all times, effective control of the nursing homes remained with First Humanics. Pursuant to various bond and trust indentures, the Company was also required to allocate a certain amount of the offerings proceeds to a debt service reserve fund. The debt service reserve fund was used to offset any insufficiencies in funds available for the semi-annual interest payments to bondholders. However, the Company was required to pay back any monies withdrawn from this account.

I. Prior to promoting the First Humanics offerings, Sutliffe was involved in the promotion of numerous other bond issues. Most of these earlier offerings, however, had experienced financial problems and some eventually defaulted prior to the Medicos offering. Furthermore. in March 1985, the State of Missouri found that Sutliffe had participated in the making of false filings, and issued a cease and desist order against him. LeGrotte was aware of Sutliffe's business and regulatory history.

J. In addition to Sutliffe's promoting activities, he also controlled First Humanics. The First Humanics officers and Board of Directors, including LeGrotte, allowed Sutliffe to dictate virtually all significant First Humanics' decisions. Sutliffe even served on various First Humanics sub-committees, including a management sub-committee. As such, Sutliffe determined which nursing homes First Humanics would acquire and was involved in the day-to-day operations of the nursing homes. Sutliffe's control was openly displayed at Board of Directors meetings and reflected in the pertinent minutes and in First Humanics internal memoranda and correspondence. Thus, although LeGrotte was an officer and director of First Humanics and was actively involved in the management of the Company, he followed the directions of Sutliffe.

K. Revenues from First Humanics' nursing homes were generally paid directly to the company and, from 1984 on, First Humanics freely and openly commingled all such revenues in a central bank account located in Dixon, Illinois (Dixon account). First Humanics then used the revenues from any one nursing home to pay the expenses of other homes, as the need arose. When a nursing home's revenues were insufficient to meet a bond payment money was simply taken from available funds in the Dixon account, whatever the source. Each nursing home's expenses were paid according to the urgency of the bill and not limited by the amount of revenue generated by the particular nursing home. From 1986 onward, however, most of the nursing homes failed to generate an amount of revenues sufficient to meet their own expenses. As a result, commingling became essential to the operation and survival of First Humanics. The success or failure of any one nursing home was thereby dependent upon the success or failure of all the other nursing homes. Therefore, each municipal offering was, in fact, a de facto investment into First Humanics and its existing nursing homes. LeGrotte was, in fact, aware that the use of one nursing home's revenues to pay anothers expenses was essential to the operation of First Humanics. Thus, LeGrotte acknowledged that a problem in any one nursing home would have an effect on the other nursing homes.

L. In addition, the vast majority of First Humanics' nursing homes were located in Illinois and heavily dependent on Illinois' Medicaid reimbursements, which were often insufficient and continually late. Given the nursing homes interdependence, as the result of the commingling discussed above, such late and insufficient payments affected all nursing homes, even those located outside of Illinois. Thus, largely because of the medicaid problems in late 1985 First Humanics became late in its required monthly bond payments to the indenture trustees for certain bond issues. Therefore, First Humanics began using the funds from some of these delinquent nursing homes' debt service reserve accounts to offset the insufficiencies. Although First Humanics was required to pay back monies withdrawn from such accounts, these payments were often late and insufficient. LeGrotte was aware of both the Medicaid problems and the late and insufficient payments to the debt service reserve funds.

M. As a result of First Humanics' cash flow shortages, First Humanics also became reliant on the working capital generated from new bond offerings as a source of funds for current operations. Additionally, a procedure was developed whereby Sutliffe "kicked-back" a portion of his acquisition fee to First Humanics at or shortly after, each bond closing. Thus, the success of

existing nursing homes and the payments to existing bondholders became largely dependent on First Humanics' ability to obtain funds from future offerings. In this manner, First Humanics operated a Ponzi scheme in which LeGrotte participated.

N. Nonetheless, First Humanics continued to be late in its monthly bond payments to the trustees. As a result, First Humanics also continued to deplete certain bond issues' debt service reserve funds. In August 1986, one of the trustees, in fact, informed First Humanics that based on its continued failure to repay these funds it was in violation of four of its bond indentures and, therefore, in technical default. First Humanics experienced a $912,946 loss before depreciation for its fiscal year ended November 30, 1986, even including Sutliffe's kickbacks. Furthermore, none of the nursing homes had met their cash flow projections as stated in their offering circulars. In December 1986, one of the trustees again informed First Humanics that it was in technical default on two of its municipal bonds. However, Sutliffe caused six new bond issues to close on December 18, 1986. As a result, and in connection with the First Humanics Ponzi scheme, additional working capital was 7 generated and, undisclosed to investors, $500,000 of Sutliffe's acquisition fee was kicked-back to First Humanics. These funds were immediately applied to cure First Humanics' monthly bond payment deficits and to pay its pact due bills. Nonetheless, First Humanics' cash flow problems continued.

MEDICOS OFFERING

O. Despite First Humanics' financial problems, in 1987 Sutliffe directed First Humanics to acquire Medicos. Connection therewith, Sutliffe arranged to have the City of Detroit issue $6,955,000 in tax-exempt bonds. Sutliffe directed LeGrotte and other First Humanics board members to issue $530,000 in taxable bonds to cover the issuance expenses; series of bonds were issued pursuant to one offering circular.

P. Sutliffe, acting as the promoter, then began the offering process by assembling the working group which provided the Medicos offering circular. LeGrotte attended these group meetings. Again, Sutliffe largely directed the women group's activities as the undisclosed promoter for Medicos. Although LeGrotte was not primarily responsible for drafting Medicos offering circular, he assisted with its preparation. Furthermore, LeGrotte signed the offering circular on behalf of First Humanics.

Q. Upon completion of the offering process, Sutliffe coordinated the Medicos bond closing. The Medicos offering closed on October 15, 1987 and the municipal and corporate bonds were sold to the public through underwriters and various broker-dealers. Upon receiving the proceeds from the underwriters, municipal issuer purchased Medicos and thereafter leased the facility back to First Humanics. At closing, LeGrotte signed pertinent acquisition and closing documents. In addition, LeGrotte signed certifications stating that the Medicos offering circular did not misrepresent or omit to state any material facts. Finally, Sutliffe kicked-back approximately $200.00 of his Medicos acquisition fee to First Humanics as part of Humanics' ongoing Ponzi scheme.

R. The Medicos offering circular omitted to disclose numerous material facts. For instance, the Medicos offering circular failed to adequately

disclose Sutliffe's promotion of the Medicos offering, his control over First Humanics, his bond failures and his past securities law sanctions. Additionally, the Medicos offering circular portrayed Medicos as a "stand alone" nursing home. Thus, the Medicos offering was simply presented as an investment into Medicos. In connection therewith, the offering circular stated that the bondholders' ability to receive interest and principal payments was dependent on the revenues derived from the operation of Medicos, not First Humanics' other nursing homes. As a result, nothing adequately describing the commingling of nursing home revenues or resulting financial interdependence among First Humanics' homes was disclosed. Thus, Medicos bondholders were also not informed that Medicos revenues would be used to pay Humanics existing nursing homes' expenses. Consequently, bondholders were not informed that, in fact, their investments constituted de facto investments into First Humanics and its existing nursing homes and not merely Medicos.

S. Similarly, the serious Illinois Medicaid problem which at the time was adversely affecting all First Humanics' nursing homes was not disclosed. Thus, Medicos bondholders were not informed that, given the nursing homes' financial interdependence, their future bond payments were largely dependent on First Humanics' ability to secure the late Medicaid payments from the State of Illinois. The offering circular also failed to disclose both the August and December 1986 defaults which related directly to First Humanics' ability to pay bondholders.

T. Finally, neither Sutliffe's $200,000 kick-back nor first Humanics' dependence on the capital generated from future offerings to finance its existing nursing homes, as part of its ongoing ponzi scheme, were disclosed. Thus, Medicos bondholders were not informed that their ability to receive payments was also dependent on First Humanics' ability to secure funds from, future offerings.

U. Through LeGrotte's role as an officer and director and his participation in the Medicos offering process LeGrotte was aware of the above material facts. In addition, through his participation in the drafting of the Medicos offering circular LeGrotte knew or should have known that the Medicos offering circular omitted these facts. However, despite this knowledge, LeGrotte actively encouraged the sale of the Medicos bonds to the public by voting to approve the acquisition, signing the offering circular, signing pertinent bond closing documents and certifying that the offering circular contained no material misrepresentations or omissions.

V. Respondent LeGrotte caused violations of Section 17(a) of the Securities Act in that he, in the offer or sale of certain securities, namely Medicos municipal bonds and First Humanics corporate bonds described in paragraphs II. A. and O. above, by use of the means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly, caused the: employing of devices, schemes or artifices to defraud; obtaining of money or property by means of untrue statements of material facts or omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or engaging in transactions, practices or courses of business which operated as a fraud or deceit upon purchasers or prospective purchasers. As part of the aforesaid conduct, Respondent caused misrepresentations and omissions of material fact to be

made to purchasers and prospective purchasers regulatory history and numerous prior bond and business failures; First Humanics' prevalent commingling of revenues from past nursing home projects and the resulting financial interdependence of all First Humanics nursing homes; the Illinois Medicaid problem; and First Humanics' on-going ponzi scheme.

W. Respondent LeGrotte caused violations of Section 10(b) of the Exchange Act and, Rule 10b-5 promulgated thereunder in that he, in connection with the purchase or sale of certain securities, namely Medicos municipal bonds and First Humanics corporate bonds described in paragraphs II. A. and O above. by use of the means or instrumentalities of interstate commerce or by the use of the mails. directly or indirectly, caused the: employing of devices, schemes or artifices to defraud; making of untrue statements of material facts or omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made not misleading or engaging in acts, practices or courses of business which operated as a fraud or deceit. As part of the aforesaid conduct. Respondent caused misrepresentations and omissions of material fact to be made to purchasers and sellers concerning, among other things, Sutliffe's role in promoting the offering. his control over First Humanics as well as his regulatory history and numerous prior bond and business failures; First Humanics' prevalent commingling of revenues from past nursing home projects and the resulting financial interdependence of all First Humanics nursing homes; the Illinois Medicaid problem; and, First Humanics' on-going ponzi scheme.

III. In view of the foregoing, it is in the public interest to impose the sanctions agreed to in the Offer of Settlement.

Accordingly, IT IS HEREBY ORDERED THAT, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Joseph LeGrotte cease and desist from committing or causing any violation, and committing or causing any future violation, of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10-b promulgated thereunder.

To Contents

In re Sidney Gould, Securities Act Release No. 7201, Exchange Act Release No. 36037, A.P. File No. 3-8764 (July 31, 1995).

I. The Commission deems it appropriate and in the public interest that public administrative proceedings be instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Sidney Gould ("Gould").

In anticipation of the institution of these administrative proceedings, Gould has submitted an Offer of Settlement which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceeding brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to jurisdiction, which is admitted, Gould consents to the entry of this Order Instituting Proceedings pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Making Findings and

Imposing a Cease and Desist Order.

Accordingly, it is ordered that proceedings pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act be, and hereby are, instituted.

II. On the basis of this Order and the Offer of Settlement submitted by Gould, the Commission makes the following findings:[n1]

ENTITY INVOLVED

A. First Humanics Corp. ("First Humanics" or "the company"), a not-for-profit corporation, was in the business of acquiring, renovating and operating nursing homes. From 1984 through 1989, First Humanics renovated and operated 21 nursing homes acquired through 21 separate offerings totalling approximately $82 million in publicly sold municipal and corporate bonds. On October 15, 1987, the Economic Development Corporation of the City of Detroit, Michigan, for the benefit of First Humanics, acquired the Medicos Recovery Care Center (Medicos) through the issuance of $6,955,000 in tax-exempt bonds. This was First Humanics' last offering.

RESPONDENT

B. Gould was an officer and director of First Humanics from 1986 to 1989. Gould reviewed the Medicos offering circular, participated in earlier First Humanics offerings and bond closings and was involved in the operations of First Humanics.

BACKGROUND

C. In connection with each offering, First Humanics contracted to purchase a particular nursing home. To finance the purchase, the Company arranged for a municipality to issue tax-free municipal bonds. However, the Company remained liable for all payments to bondholders. To finance the issuance costs on certain of the above offerings, the Company, in some instances, also issued a modest amount of corporate bonds in conjunction with the tax-exempt bonds. Again, the Company was liable for all payments to bondholders.

D. Each prospective nursing home was initially located by Lee F. Sutliffe ("Sutliffe"), the undisclosed control person of First Humanics and the undisclosed promoter of First Humanics' offerings. If Sutliffe decided the nursing home was acceptable for acquisition, the First Humanics Board of Directors then voted to acquire the facility. Sutliffe received an acquisition fee of between $100,000 and $300,000 in connection with each nursing home purchased by First Humanics.

E. Subsequent to the Board's approval, Sutliffe initiated the offering process, through which First Humanics obtained the funds necessary to purchase the nursing home. In connection therewith, Sutliffe assembled an offering "working group" which coordinated the offering process and was responsible for preparing the offering circulars. The activities of the First Humanics working group were largely directed by Sutliffe. In this manner,

Sutliffe acted as the promoter of the offerings. Gould sometimes participated in working group meetings and also reviewed offering materials prepared by the working group.

F. In connection with each offering, an offering circular was prepared. The offering circular typically contained sections describing First Humanics, the nursing home to be acquired, the bonds, sources and uses of bond proceeds, risk factors and, as appendices, a financial feasibility study and the Company's audited financial statements. The primary purpose of the offering circular was to provide the investing public with all material facts pertaining to the offering. Gould reviewed offering circular drafts, commented on certain drafts, and executed numerous supporting documents which were used in connection with the drafting of the offering circular. Thus, he was involved in the process of preparing offering circulars.

G. Upon completion of the offering process, Sutliffe coordinated the bond closings. At each bond closing, the municipal issuer sold the bonds to an underwriter who, in turn, re-sold them to the investing public through various retail broker-dealers. Upon receiving the bond proceeds from the underwriter, the municipal issuer either lent such proceeds to First Humanics so that the Company could purchase the nursing home and leased it back to the Company. A certain amount of bond proceeds were also set aside as working capital for the benefit of First Humanics.

H. Immediately after closing, First Humanics assumed the municipal issuer's repayment obligation to the bondholders. Thereafter, the Company was required to make monthly bond payments to the indenture trustee sufficient for the trustee to meet semi-annual interest payments to the bondholders. At all times, effective control of the nursing homes remained with First Humanics. In addition, pursuant to various bond and trust indentures, the Company was required to allocate a certain amount of each offering's proceeds to a debt service reserve fund. The debt service reserve fund was used to offset any insufficiencies in funds available for the semi-annual interest payments to bondholders. However, the Company was required to pay back any monies withdrawn from this account.

I. Prior to promoting the First Humanics offerings, Sutliffe was involved in the promotion of numerous other bond issues. Most of these earlier offerings, however, had experienced financial problems and some eventually defaulted prior to the Medicos offering. Furthermore, in March 1985, the State of Missouri found that Sutliffe had participated in the making of false filings, and issued a cease and desist order against him. Gould was aware of Sutliffe's business and regulatory history.

J. In addition to Sutliffe's promoting activities, he also controlled First Humanics. The First Humanics officers and Board of Directors, including Gould, allowed Sutliffe to dictate virtually all significant First Humanics' decisions. Sutliffe even served on various First Humanics' Board sub-committees, including a management sub-committee. As such, Sutliffe determined which nursing homes First Humanics would acquire and was involved in the day-to-day operations of the nursing homes. Sutliffe's control was openly displayed at Board of Directors meetings and reflected in the pertinent minutes and in First Humanics internal memoranda and correspondence. Thus, although Gould was an officer and director of First

Humanics and was involved in the management of the Company, he followed the directions of Sutliffe.

K. Revenues from First Humanics' nursing homes were generally paid directly to the company and, from 1984 on, First Humanics freely and openly commingled all such revenues in a central bank account located in Dixon, Illinois (Dixon account). First Humanics then used the revenues from any one nursing home to pay the expenses of other nursing homes, as the need arose. When a nursing home's revenues were insufficient to meet a bond payment, money was simply taken from available funds in the Dixon account, whatever the source. Thus, each nursing home's expenses were paid according to the urgency of the bill and not limited by the amount of revenue generated by the particular nursing home. From 1986 on, however, most of the nursing homes failed to generate an amount of revenues sufficient to meet their own expenses. As a result, commingling became essential to the operation and survival of First Humanics. The success or failure of any one nursing home was thereby dependent upon the success or failure of all the other nursing homes. Therefore, each municipal offering was, in fact, a de facto investment into First Humanics and its existing nursing homes. Gould was, in fact, aware that the use of one nursing home's revenues to pay another's expenses was essential to the operation of First Humanics.

L. In addition, the vast majority of First Humanics' nursing homes were located in Illinois and heavily dependent on Illinois' Medicaid reimbursements, which were often insufficient and continually late. Given the nursing homes interdependence, as the result of the commingling discussed above, such late and insufficient payments affected all nursing homes, even those located outside of Illinois. Thus, largely because of the Medicaid problems, in late 1985 First Humanics became late in its required monthly bond payments to the indenture trustees for certain bond issues. Therefore, First Humanics began using the funds from some of these delinquent nursing homes' debt service reserve accounts to offset the insufficiencies. Although First Humanics was required to pay back monies withdrawn from such accounts, these payments were often late and insufficient. Gould was aware of both the Medicaid problems and the late and insufficient payments to the debt service reserve funds.

M. As a result of First Humanics' cash flow shortages, First Humanics also became reliant on the working capital generated from new bond offerings as a source of funds for current operations. Additionally, a procedure was developed, of which Gould was aware, whereby Sutliffe "kicked-back" a portion of his acquisition fee to First Humanics at, or shortly after, each bond closing. Thus, the success of existing nursing homes and the payments to existing bondholders became largely dependent on First Humanics' ability to obtain funds from future offerings. In this manner, First Humanics operated a Ponzi scheme in which Gould participated.

N. Nonetheless, First Humanics continued to be late in its monthly bond payments to the trustees. As a result, First Humanics also continued to deplete certain bond issues' debt service reserve funds. In August 1986, one of the trustees, in fact, informed First Humanics that based on its continued failure to repay these funds it was in violation of four of its bond indentures and, therefore, in technical default. First Humanics experienced a $912,946 loss before depreciation for its fiscal year ended November 30,

1986, even including Sutliffe's kick-backs. Furthermore, none of the nursing homes had met their cash flow projections as stated in their offering circulars. In December 1986, one of the trustees again informed First Humanics that it was in technical default on two of its municipal bonds. However, Sutliffe caused six new bond issues to close on December 18, 1986. As a result, and in connection with the First Humanics Ponzi scheme, additional working capital was generated and, undisclosed to investors, $500,000 of Sutliffe's acquisition fee was kicked-back to First Humanics. These funds were immediately applied to cure First Humanics' monthly bond payment deficits and to pay its past due bills. Nonetheless, First Humanics' cash flow problems continued.

MEDICOS OFFERING

O. Despite First Humanics' financial problems, in early 1987 Sutliffe directed First Humanics to acquire Medicos. In connection therewith, Sutliffe arranged to have the City of Detroit issue $6,955,000 in tax-exempt bonds. Sutliffe also directed Gould and other First Humanics board members to issue $530,000 in taxable bonds to cover the issuance expenses. Both series of bonds were issued pursuant to one offering circular.

P. Sutliffe, acting as the promoter, then began the offering process by assembling the working group which prepared the Medicos offering circular. Again, Sutliffe largely directed the working group's activities as the undisclosed promoter for Medicos. Gould reviewed the Medicos offering circular and the related offering documents. Although Gould was not primarily responsible for drafting the Medicos offering circular, as an officer he was involved in its preparation.

Q. Upon completion of the offering process, Sutliffe then coordinated the Medicos bond closing. The Medicos offering closed on October 15, 1987 and the municipal and corporate bonds were sold to the public through underwriters and various broker-dealers. Upon receiving the proceeds from the underwriters, the municipal issuer purchased Medicos and thereafter leased the facility back to First Humanics. At closing, Gould, signed pertinent acquisition and closing documents necessary for the offering to close. In addition, Gould signed certifications stating that the Medicos offering circular did not misrepresent or omit to state any material facts. Finally, Sutliffe kicked-back approximately $200,000 of his Medicos acquisition fee to First Humanics as part of First Humanics' ongoing Ponzi scheme.

R. However, the Medicos offering circular omitted to disclose numerous material facts. For instance, the Medicos offering circular failed to adequately disclose Sutliffe's promotion of the Medicos offering, his control over First Humanics, his prior bond failures and his past securities law sanction. Additionally, the Medicos offering circular portrayed Medicos as a "stand alone" nursing home. Thus, the Medicos offering was simply presented as an investment into Medicos. In connection therewith, the offering circular stated that the bondholders' ability to receive interest and principal payments was dependent on the revenues derived from the operation of Medicos, not First Humanics' other nursing homes. As a result, nothing adequately describing the commingling of nursing home revenues or the resulting financial interdependence among First Humanics' nursing

homes was disclosed. Thus, Medicos bondholders were also not informed that Medicos revenues would be used to pay First Humanics existing nursing homes' expenses. Consequently, bondholders were not informed that, in fact, their investments constituted de facto investments into First Humanics and its existing nursing homes and not merely Medicos.

S. Similarly, the serious Illinois Medicaid problem which at the time was adversely affecting all First Humanics' nursing homes was not disclosed. Thus, Medicos bondholders were not informed that, given the nursing homes' financial interdependence, their future bond payments were largely dependent on First Humanics' ability to secure the late Medicaid payments from the State of Illinois. The offering circular also failed to disclose both the August and December 1986 defaults which related directly to First Humanics' ability to pay bondholders.

T. Finally, neither Sutliffe's $200,000 kick-back nor First Humanics' dependence on the capital generated from future offerings to finance its existing nursing homes, as part of its ongoing ponzi scheme, were disclosed. Thus, Medicos bondholders were not informed that their ability to receive payments was also dependent on First Humanics' ability to secure funds from future offerings.

U. Through Gould's role as an officer and director and his participation in the Medicos offering process Gould was aware of the above material facts. In addition, through his participation in the Medicos offering process, Gould knew or should have known that the Medicos offering circular omitted these facts. However, despite this knowledge, Gould actively encouraged the sale of the Medicos bonds to the public by voting to approve the acquisition, signing pertinent bond closing documents and certifying that the offering circular contained no misrepresentations or omissions of material fact.

V. Respondent Gould caused violations of Section 17(a) of the Securities Act in that he, in the offer or sale of certain securities, namely Medicos municipal bonds and First Humanics corporate bonds described in paragraphs II. A. and O. above, by use of the means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly, caused the employing of devices, schemes or artifices to defraud; obtaining of money or property by means of untrue statements of material facts or omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or engaging in transactions, practices or courses of business which operated as a fraud or deceit upon purchasers or prospective purchasers. As part of the aforesaid conduct, Respondent caused misrepresentations and omissions of material fact to be made to purchasers and prospective purchasers concerning, among other things, Sutliffe's role in promoting the offering, his control over First Humanics as well as his regulatory history and numerous prior bond and business failures; First Humanics' prevalent commingling of revenues from past nursing home projects and the resulting financial interdependence of all First Humanics nursing homes; the Illinois Medicaid problem; and, First Humanics' on-going ponzi scheme.

W. Respondent Gould caused violations of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder in that he, in connection with the purchase or sale of certain securities, namely Medicos municipal bonds

and First Humanics corporate bonds described in paragraphs II. A. and O. above, by use of the means or instrumentalities of interstate commerce or by the use of the mails, directly or indirectly, caused the: employing of devices, schemes or artifices to defraud; making of untrue statements of material facts or omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or engaging in acts, practices or courses of business which operated as a fraud or deceit. As part of the aforesaid conduct, Respondent caused misrepresentations and omissions of material fact to be made to purchasers and sellers concerning, among other things, Sutliffe's role in promoting the offering, his control over First Humanics as well as his regulatory history and numerous prior bond and business failures; First Humanics' prevalent commingling of revenues from past nursing home projects and the resulting financial interdependence of all First Humanics nursing homes; the Illinois Medicaid problem; and, First Humanics' on-going ponzi scheme.

III. In view of the foregoing, it is in the public interest to impose the sanctions agreed to in the Offer of Settlement.

Accordingly, IT IS HEREBY ORDERED THAT, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Sidney Gould cease and desist from committing or causing any violation, and committing or causing any future violation, of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

Footnotes

-[n1]- The findings herein are made pursuant to Gould's offer of settlement and are not binding on any other person or entity named as a respondent in this or any other proceeding.

To Contents

http://www.sec.gov/info/municipal/mbonds/publicof.htm

KPMG LLP
Three Embarcadero Center
San Francisco, CA 94111

Telephone 415 951 0100

October 11, 2004

Leslie J. Girard, Esq.
Assistant City Attorney
Office of the City Attorney
City of San Diego
1200 Third Avenue, Suite 1620
San Diego, CA 92101

RE: CITY OF SAN DIEGO FISCAL YEAR 2003 AUDIT

Dear Mr. Girard:

As shared in previous meetings and correspondence, including our letters dated August 9, 2004 and September 1, 2004, we do not believe that the City of San Diego ("City") has conducted an adequate investigation in order to conclude that likely illegal acts have not occurred, or that appropriate remedial action has been taken. Such an investigation is necessary in order for an auditor to complete an audit in accordance with generally accepted auditing standards and *Government Auditing Standards.*

The primary purpose of this letter is to express KPMG's position on what additional action KPMG believes the City should take relating to the investigation and remediation of potential illegal acts to enable KPMG to complete its audit of the City's basic and fund financial statements for the fiscal year ended June 30, 2003. KPMG has been concerned that the City was not undertaking an investigation specifically designed for the purpose of addressing audit responsibilities under generally accepted auditing standards and *Government Auditing Standards* relating to possible illegal acts. At the City's request, and as reflected in our September 1, 2004 letter, KPMG agreed to await the completion of the Vinson & Elkins ("V&E") report (the "Report"), to review the Report, and to advise the City as to what, if any, further information KPMG required in order to be in a position to complete its audit and issue its audit reports. As discussed, and as explained in more detail below, our overriding concern has been and remains, that an investigation must be of sufficient scope and thoroughness to provide a sound basis for concluding either that illegal acts with relevance to the City's financial reporting have not occurred or that appropriate remedial action has been taken with respect to any conduct which the City and its counsel cannot definitively conclude was legal.

At your request and to make our next meeting as constructive as possible, we have attempted in this letter to synthesize what additional action we believe the City needs to take to enable KPMG to complete its audit, and also to explain in general terms why this additional action is necessary.

KPMG LLP, KPMG LLP, a U.S. limited liability partnership, is a member of KPMG International, a Swiss association.

EXHIBIT # 76

BACKGROUND

We understand that the SEC is conducting a formal investigation of the City of San Diego's public disclosures relating to the SDCERS in the City's bond offerings during the period 1996 through January 2004. This investigation was commenced following the City's filing of a Voluntary Report of Information on January 27, 2004 with the Municipal Securities Rulemaking Board and the Nationally Recognized Municipal Securities Information Repositories. That Voluntary Report made new disclosures regarding the City's obligations to fund the SDCERS and also disclosed that there had been errors in the City's 2002 CAFR.

We also understand that the U.S. Attorney and FBI are conducting a criminal investigation relating to the City's pension funding and disclosures. There have also been press reports of an additional investigation by the FBI relating to possible "public corruption" issues relating to the process by which the City and SDCERS have negotiated and approved various agreements in which the City's obligations to make payments to fund SDCERS were reduced and/or deferred in exchange for agreements to increase or expand benefits.

We understand that all of these investigations are focused on the conduct of individuals who either are currently employed by the City, were employed by the City during the period covered by KPMG's ongoing audit, or were acting in some manner on behalf of the City or SDCERS during the relevant time period.[1]

V&E was retained by the City and conducted an investigation into the City's disclosure practices and prepared a report. The V&E Report, which was made public on September 16, 2004, describes systemic failures in the City's financial reporting and disclosure processes related to the SDCERS pension plan. See e.g., Report at 170-171 (referring to "across the board failures of the City's internal disclosure processes.") It also reflects that, as late as the fall of 2003 the City's Disclosure Counsel thought information was being withheld from him and there were fundamental disagreements about whether acknowledged errors in the historical financial statements were material. Report at 114-120. The Report acknowledges that the City's prior SDCERS related disclosures were inadequate, and while it appears to stop short of concluding that there were material misstatements in the City's disclosures, it describes a dysfunctional disclosure system and also comments upon the City's "minimalist approach to public disclosure." Among the observations supporting this conclusion is the statement that "the City Auditor was disinclined to

[1] Potential illegal acts by SDCERS or its board are relevant to KPMG's audit. Your position (expressed in the September 20, 2004 letter), that SDCERS is an "entity independent of the City," does not address the fact that the financial condition of SDCERS is reported as a fiduciary fund in the City's CAFR.

include information in the City disclosure that reflected badly on the City and would sometimes excise negative statements from disclosure documents." Report at 117.

The V&E report includes two paragraphs under a heading "Conclusions Regarding Intent." Report at 164. These paragraphs state that because many of the "gaps" in the City's disclosures are "closed" when information in the SDCERS CAFRs is considered and because local press coverage of the pension plan highlighted many of the risks surrounding the more controversial City funding agreements (Managers 1 and 2) and the presence in the Municipal Code of the menu for distribution of surplus earnings, any attempt to conceal the SDCERS funding situation would have been an "exercise in futility."

While we understand that V&E has concluded that it has gathered sufficient evidence to support this conclusion, for purposes of our audit, we note that this conclusion does not address the questions we have posed as being important to our completion of our audit, and therefore, does not end our inquiry. Indeed at our meeting on August 27, 2004, Both the City and V&E have made it clear to KPMG that V&E was not retained to investigate issues relating to intent or whether any individual's conduct violated any law, rule or regulation, and that the scope of its investigative efforts were not designed to do so. At that meeting, we informed the City that, in the absence of conclusions on such issues, KPMG anticipated advising the City that additional investigative procedures may be necessary before KPMG would be in a position to complete its audit; and, in turn, we were advised that the City would perform any additional inquiries that KPMG believe were necessary for it to be able to conclude on issues that might affect its ability to issue an audit opinion.

Unfortunately, based upon the information we have been provided to date regarding the scope and method of the V&E investigation, we do not believe the statement in the report that "it is difficult to attribute the City's failure to fully and accurately describe [pension] matter[s] to intentional misconduct on the part of individual employees" is sufficient to resolve the issue of potential illegal acts for purposes of KPMG's audit because it is not based on an investigation that had a scope and methodology that would provide a reliable basis for reaching a conclusion as to whether City officials engaged in intentional misconduct or other conduct, which violated any law, rule or regulation having the force of law.

It is in this context and against these background facts, that KPMG's requirements, as outlined in this letter, must be understood. Most fundamentally, because there is evidence of possible illegal acts by the City or persons whose acts are attributed to it, under Generally Accepted Auditing Standards (GAAS) and Generally Accepted *Government Auditing Standards* (GAGAS), as well as other relevant professional guidance, to the extent the following questions are not directly

addressed in the V&E Report, additional investigative procedures are required in order to determine if illegal acts are likely to have occurred, to assess the direct or indirect effect of such acts on the City's financial statements as well as the implications for the reliability of representations being made by City employees to KPMG in the course of our audit, and to determine if any such illegal acts have been adequately remediated by the City.

The report based on such an investigation must include clear conclusions and be supported by a thorough investigation. However, as stated above, and as KPMG has been advised, the V&E investigation was not conducted as a forensic investigation, and did not result in a report that reached clear conclusions about whether federal securities laws (or any other relevant laws) had been violated, did not explore potential individual conduct that may be fraudulent or unlawful, and thus does not provide a basis for determining potential financial statement effects or determining KPMG's ability to rely on management representations from the City.

Further, the Report's discussion of certain evidence raises a concern that the investigation, for our purposes, did not adequately follow up on evidence which might suggest that certain of the deficiencies in financial reporting may have been the result of conscious efforts by one or more persons at the City. In the absence of an investigation and report that adequately explores these issues, it is not possible to determine if the City has taken appropriate remedial measures or if the representations made to us during our audit by certain individuals can be relied upon by us in reaching our opinion on the financial statements.[2]

In this regard it also bears noting that the remedial measures recommended in the Report are all prospective and entail structural reforms to address the City's process of disclosure in the future. These reforms are subject to approval by the City Council and, even if adopted, would have no impact on the manner in which the City will have prepared its 2003 audited financial statements.

---

[2] See Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions Exchange Act Release No. 44969, 2001 SEC LEXIS 2210 (Oct. 23, 2001), arising out of an investigation into financial reporting by Seaboard Corporation.

OVERVIEW OF RELEVANT AUDITING AND ACCOUNTING REQUIREMENTS

AICPA State and Local Audit and Accounting Guide § 4.44.

(1) Illegal Acts with Direct and Material Effects on Financial Statement Amounts

GAAS requires an auditor to plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatements arising from illegal acts that have a direct and material effect on the determination of financial statement amounts. The auditor's consideration of those potential misstatements is a matter of professional judgment and is influenced by his or her perceptions of the needs of a reasonable person who will rely on the financial statements.

The professional literature identifies the following types of legal compliance requirements as among those that may have a "direct and material" effect on the determination of financial statement amounts.

- GAAP Requirements. Governments often are subject to legal or contractual provisions that require them to prepare their financial statements in conformity with GAAP.

- Federal and State Taxes. Governments are subject to various federal tax requirements, including those relating to employment taxes, employee benefits, and tax-exempt debt (such as arbitrage rebate requirements). State-level tax requirements also may apply.

(2) Illegal Acts With Indirect Effects on Financial Statements

The auditing literature also recognizes that Governments often are affected by many other laws or regulations, which generally relate more to an entity's operating aspects than to its financial and accounting aspects, and that the financial statement effect of those laws and regulations is "indirect". Although an auditor is not required to plan the audit to detect noncompliance with such laws and regulations, the auditor does have certain detection, consideration, and reporting responsibilities relating to potential violations of such laws, which require the auditor to insist that when potential violations of such laws come to light, they must be investigated.

Moreover, GAAP requires a government entity, such as the City, to disclose in its financial statements material violations of finance-related legal and contractual provisions. Accordingly, the

auditor of a governmental entity is alert to the possible financial reporting effect of noncompliance with law that has a material indirect effect on financial statements. Because the government entity itself has financial statement reporting obligations related to violations of such laws, the government and the auditor both have a shared interest in assuring that when potential violations of such laws come to light, they are fully investigated so that the financial statements can include the GAAP[3] required disclosure.

In considering whether the financial statements are free of material misstatements arising from (1) illegal acts that have a direct and material effect on the determination of financial statement amounts, or (2) illegal acts that have an indirect material effect on financial statements, the auditor should consider both quantitative and qualitative factors. Qualitative factors that the auditor may consider relevant to that evaluation include the following:

- The potential effect of the noncompliance on the government's ability to raise resources (for example, through taxes, grants, contributions, or debt or loan financings) in the future.
- The potential effect of the noncompliance on the continuation of existing relationships with vendors, employees, and elected and appointed officials.
- Whether the noncompliance involves collusion or concealment.
- Whether the noncompliance involves an activity that often is scrutinized by elected or appointed officials, citizens, the press, creditors, or rating agencies.
- Whether the fact of the noncompliance is unambiguous rather than a matter of judgment.
- Whether the noncompliance is an isolated event or instead has occurred with some frequency.

[3] GASB standards require governments to disclose certain violations of compliance requirements. NCGA Interpretation 6, Notes to the Financial Statements Disclosure, paragraph 4, states that the notes to the financial statements should disclose material violations of finance-related legal and contractual provisions. In addition, material violations, or potential violations, of finance-related legal and contractual provisions should be considered for recording a loss contingency. Id. at § 4.48.

- Whether the noncompliance results from management's continued unwillingness to correct internal control weaknesses.
- The likelihood that similar noncompliance will continue in the future.
- The cost-benefit of establishing internal control to prevent similar noncompliance in the future.

The risk that possible undetected noncompliance would affect the auditor's evaluation.[4]

Finally, an auditor is required by applicable auditing standards to "consider the implications of an illegal act in a relation to other aspects of the audit, particularly the reliability of representations of management." AU § 317.16. In considering such issues, the auditor must be provided with sufficient information relating to the potential illegal acts to exercise professional judgment concerning the implications of a particular illegal act for the audit. Id. ("The implications of particular illegal acts will depend on the relationship of the perpetration and concealment, if any, of the illegal act to specific control procedures and the level of management or employees involved.") Our April 13, 2004 engagement letter allows KPMG to make such a determination as to the sufficiency of the investigation for audit purposes.

INFORMATION AND REOCRDS REQUESTED, NOT YET PROVIDED

There are several open items which have been promised, but not yet provided to KPMG.

- KPMG has yet to receive all V&E interview notes, memoranda and supporting documents as requested. The basis for this request is outlined in our engagement letter.
- KPMG needs information concerning the scope and status of the criminal investigation(s), which we understand V&E is not handling. We will need to speak with the attorney representing the City in those matters.

ITEMS REQUIRING RESOLUTION BY THE CITY

Based on our review of the V&E investigation and Report, and in light of the auditing standards discussed above, KPMG has attempted to synthesize the issues that remain, which must be

[4] Id. at § 4.46

resolved before we are able to complete our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*. They are as follows:

- The City needs to determine whether the City's public disclosures, including its financial statements, likely violate the antifraud provisions of the securities laws (e.g., failure to disclose pension related matters) or any other Federal, State or local laws, and if so, what, if any, impact is there to the June 30, 2003 financial statement amounts and disclosures? The report from the investigation team should include clear conclusions (with adequate support for such conclusions) whether an illegal act has occurred and whether such illegal act has been timely and adequately remediated. The report and investigation must be in sufficient scope and detail to allow us to reach our own conclusions as to (i) whether it is likely that an illegal act has occurred and, if so (ii) whether any likely illegal act that is identified will have a material effect on the entity's financial statements and, if so (iii) whether timely and appropriate remedial action has been taken. Closely related to this set of issues is whether City employees or agents have engaged in fraudulent actions including concealment, related to the potential illegal acts. The City needs to investigate and determine, and report to us, the relationship of the perpetration and concealment, if any, of likely illegal acts to specific control objectives and the level of management, employees, or consultants involved.

- The scope of the investigation needs to extend to all possible illegal acts and needs to expand, as necessary, based on findings made during the investigation. In other words, the investigators should be able to pursue all evidence of possible illegal acts no matter where they may lead.

- According to the Report, retiree healthcare benefits were paid directly out of the pension system from 1983 until 1992 when a determination was made that this violated federal tax regulations. A new system was set up which was also determined to be legally flawed in 1995, which was addressed by making payments a SDCERS benefit. While the Report compiles facts relating to this violation, and concludes that the funding method was violative of federal regulations, it does not address the possible consequences of this violation. What has the city done to consider and address the financial statement impact of possible IRS sanctions, or other contingent liabilities or disclosure obligations arising from the conduct that could impact the June 30, 2003 financial statement amounts and disclosures?

KPMG

Mr. Leslie J. Girard
Assistant City Attorney
Office of the City Attorney
City of San Diego
October 11, 2004
Page 9

- IN ADDITION THE INVESTIGATION MUST ADDRESS ALLEGATIONS RELEASED FROM DIANA SHIPPING AFTER THE DELIVERY OF THIS LETTER.
- The issues from our August 9, 2004 letter must be addressed (see discussion in Exhibit I)

We look forward to meeting with the City to discuss further how the City can conduct an adequate investigation in order to conclude whether it is likely or not illegal acts have occurred, or that appropriate remedial action has been taken.

Very truly yours,

KPMG LLP

Steven G. DeVetter

Steven G. DeVetter
Partner

cc: Mr. Dick Murphy, Mayor
Mr. P. Lamont Ewell, City Manager
Ms. Terri Webster, Acting City Auditor and Comptroller

Exhibit I
Specific Comments Regarding September 20, 2004 City Response to KPMG's August 9, 2004 Letter

Attachments:
April 13, 2204 Engagement Letter
August 9, 2004 Letter from KPMG Re: Investigation
September 1, 2004 Letter from KPMG Re: Follow-up from meeting on August 27, 2004
September 20, 2004 letter from Les Girard Re: City of San Diego Fiscal Year 2003 Audit

Three Embarcadero Center
San Francisco, CA 94111

Telephone 415 951 0100

October 29, 2004

The Honorable Dick Murphy, Mayor
Mr. Lamont Ewell, City Manager
City of San Diego
1200 Third Avenue
San Diego, CA 92101

Gentlemen:

We write this letter in an earnest attempt to make progress with the City of San Diego towards addressing the issues that must be resolved before KPMG can complete its audit of the City's 2003 financial statements.

The immediate topic we must address is the letter dated October 28, 2004 from Paul Maco of Vinson & Elkins (V&E) addressed to Les Girard, Assistant City Attorney. That letter, which appears to have been posted immediately on the City's website, in our opinion seriously impairs, rather than advances, the prospects for a prompt resolution of the issues that currently stand in the way of KPMG completing its audit.

We will not in this letter seek to correct all of the statements in Mr. Maco's letter which we believe are inaccurate. However, we do wish to convey to you, as two individuals with significant responsibility for the City's affairs, several points, which are intended to be direct, but constructive:

First, KPMG cannot, and will not, complete an audit of the 2003 financial statements unless the City completes an independent investigation of potential illegal acts as we have outlined in our prior correspondence.

Second, KPMG does not seek, as Mr. Maco asserts, "broad and unspecified assurances that the City and its officials have not committed 'illegal acts.' " Nor do we request that the City retain counsel to "speculate on an unbounded universe of unasserted claims." We believe that our prior letters cannot reasonably be construed to have made such requests. To the contrary, we have laid out what our concerns are, and repeatedly advised the City's representatives that these concerns must be addressed through an investigation that was designed to develop facts that would enable the City and its counsel to address those concerns.

Third, while we believe it is somewhat unusual for an auditor to provide a detailed explanation to a client of the auditing standards that justify an auditor's request for information, we have done so here. In our correspondence, we not only discussed relevant auditing literature, but also explicated for the City some of the applicable accounting principles that require the City in its financial

KPMG, LLP, KPMG LLP, a limited liability partnership, is a member of KPMG International, a Swiss association.

statements to make disclosures of any violations of finance-related laws and regulations.[1] We believe that the City cannot comply with this requirement unless it conducts the kind of investigation we have requested and described in our October 11, 2004 letter. Accordingly, the investigation we are requesting is one that the City ought to desire to complete so that it can discharge its own financial reporting obligations and not solely because KPMG is insisting that it do so. The City, as the issuer of its financial statements, must conclude on the question of whether any of the issues discussed in our October 11, 2004 letter and its attachments and the conduct discussed in the V&E report was illegal and, if so, whether any violations must be disclosed, and have been adequately disclosed, in the financial statements in accordance with GAAP. We would further expect the City would also determine to its satisfaction that all necessary and appropriate remedial actions have been taken with respect to conduct that is investigated. It is because it is the City's obligation to reach these conclusions that KPMG has suggested that the City obtain from its investigators sufficiently clear legal conclusions to enable the City to make the necessary determinations; we have not, as Mr. Maco suggests requested that any law firm issue a legal opinion to KPMG on any subject and his allusion to the ABA protocol for FAS 5 (Contingent Liability) attorney letters is completely off subject. It is, thus, extremely disappointing and surprising that Mr. Maco's letter so ardently contends that KPMG has not explained the auditing standards motivating its request. It is equally troubling that his letter erroneously asserts that KPMG "was not following established auditing standards."[2]

In light of the foregoing, and considering both that Mr. Maco may not speak for the City on these matters and that (at least according to certain press reports) there may not have been adequate communication within the City about our position, we believe that a key element of our meeting on Monday November 1, 2004 will be to secure the authoritative position of the City on these important issues. Our fundamental goal for this meeting is the same one we expressed in our letter dated October 27, 2004: "to discuss how the City plans to conduct an adequately detailed investigation that will permit KPMG to conclude its audit."

If the City is prepared to proceed with an appropriate investigation, then we urge you to consider retaining counsel other than V&E to do so. The positions asserted in, and oppositional tone of, Mr. Maco's letter raises questions about V&E's willingness or ability in these circumstances to complete the investigation of, and reach conclusions on, the audit-critical questions posed in our prior oral and written communications and to do so in an objective and independent manner. Our

---

[1] In light of these requirements, the fact that the City may be exempt from Section 10A of the Securities Exchange Act of 1934 as Mr. Maco asserts, does not eliminate the City's obligations under Generally Accepted Accounting Principles ("GAAP") applicable to governments.

[2] Again, in the interest of assisting the City in understanding its obligations and explaining the professional guidance that KPMG believes is applicable here, we are enclosing a copy of a very recent Practice Alert published by the American Institute of Certified Public Accountants on "Illegal Acts".

reading of the letter suggests to us that, at this point, conducting the kind of investigation that is necessary may be in tension with V&E's ongoing representation of the City in the pending SEC investigation.

KPMG's ability to complete its audit of the City's financial statements is dependent on resolution of these outstanding issues. We have been, and will continue, to perform the service we understood the City wanted us to perform (i.e. to objectively exercise our professional judgment in the application of professional standards). We stand ready to do so in the independent manner we believe the City, the investing public and the taxpayers expect.

Very truly yours,

KPMG LLP

Steven G. DeVetter

Steven G. DeVetter
Partner

cc: Mr. Leslie Girard, Assistant City Attorney, City of San Diego

DESCRIPTION	AMOUNT	ORDINANCE/ RESOLUTION NUMBER	DATE	VOTE	UNDERWRITER	FINANCIAL ADVISOR
Public Facilities Financing Authority of the City of San Diego Lease Revenue Bonds Series 2002 B (Fire and Life Safety Facilities Project)	$ 25,070,000	O-19054	April 29, 2002	Districts 1, 2, 3, 4, 5, 6, 7, 8, and Mayor - Yea	Morgan Stanley DW Inc.	Kelling, Northcross & Nobriga
City of San Diego, California 2002-03 Tax Anticipation Notes Series A 3.00% Interest Rate @ 101.382% Price to Yield 1.70%	$ 93,200,000	R-296500	May 14, 2002	Districts 1, 2, 3, 4, 5, 6, 7, 8, and Mayor - Yea	Zions First National Bank, First Albany Corp.	Public Resources Advisory Group
Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Bonds, Series 2002 (Payable Solely From Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund)	$286,945,000	R-297070	September 16, 2002	Districts 1, 2, 3, 4, 6, 7, 8, and Mayor - Yea District 5 - Not Present	Salomon Smith Barney & E.J. De La Rosa & Co., Inc., Morgan Stanley	Montague DeRose & Associates LLC, Kitahata & Company
City of San Diego 2003 Certificates of Participation (1993 Balboa Park/Mission Bay Park Refunding) Evidencing Undivided Proportionate Interests in Lease Payments to be Made by the City of San Diego Pursuant to a Lease with the San Diego Facilities and Equipment Leasing Corporation	$ 17,425,000	R-297692	March 3, 2003	Districts 1, 2, 3, 4, 5, 6, 7, 8, and Mayor - Yea	Citigroup Global Markets Inc	Public Resources Advisory Group
City of San Diego/MTDB Authority 2003 Lease Revenue Refunding Bonds (San Diego Old Town Light Rail Transit Extension Refunding)	$ 15,255,000	R-297693	March 3, 2003	Districts 1, 2, 3, 4, 5, 6, 7, 8, and Mayor - Yea	Banc of America Securities LLC	Public Resources Advisory Group
City of San Diego, California 2003-04 Tax Anticipation Notes Series A 1.75% Interest Rate @ 100.939% Price to Yield .800%	$110,900,000	R-297969	May 20, 2003	Districts 1, 2, 3, 4, 5, 6, 7, 8, and Mayor - Yea	Goldman, Sachs & Co.	Public Resources Advisory Group
Public Facilities Financing Authority of the City of San Diego Subordinated Sewer Revenue Bonds, Series 2003A and Series 2003B (Payable Solely From Subordinated Installment Payments Secured by Wastewater System Net Revenues	$505,550,000	R-298133	June 30, 2003	Districts 1, 2, 3, 4, 5, 6, 7, and Mayor - Yea District 8 - Not Present	UBS Financial Services Inc., Merrill Lynch & Co., Redwood Securities Group, Inc.	Montague DeRose and Associates, LLC

EXHIBIT # 77