INTERIM REPORT NO. 7

SDCERS ATTORNEY-CLIENT PRIVILEGE

DOCUMENTS RELEASED UNDER FEDERAL COURT ORDER

REPORT OF THE

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I.

INTRODUCTION

The San Diego City Attorney has issued six interim reports in connection with the $1.9 billion funding crisis confronting the San Diego City Employees Retirement System (SDCERS). This report will illustrate that the approval of the City Manager's Proposal II provisions by the San Diego City Employee's Retirement System (SDCERS) on 15 November 2002 and the San Diego City Council approval of benefit enhancements on 18 November 2002 was based on a contingent, quid pro quo agreement.

In this report, the City Attorney assesses the impact on the findings in the First and Second Interim Reports of evidence recently released by SDCERS. SDCERS released more than 60,000 pages of documents in response to a court order sought by U.S. Attorney Carol Lam.

The report will also detail new evidence illustrating that trustees of the SDCERS Board used their position to boost pension benefits, including their individual benefit packages with knowledge that approving the deal would jeopardize the financial stability of the trust. Evidence in this report will show that the executive staff of SDCERS knowingly withheld information from the public.

The report will also prove that executives and trustees of SDCERS were made aware by City of San Diego officials during the early stages of negotiations that the passage of pension benefit enhancements was contingent on the SDCERS Board approving the reduction of a funding requirement within the trust.

Moreover, the City Attorney addresses other evidence recently released that bears upon the finding also reached in the first two interim reports.

II.

BACKGROUND

The financial stability of the San Diego City Employees' Retirement System (SDCERS) pension trust began to unravel significantly toward the end of 2001, with the crash of the stock market. The San Diego City Attorney issued six Interim Reports providing substantial evidence illustrating that City of San Diego officials who also sat as trustees on the SDCERS Board of director were cognizant of the impending financial crisis of the pension trust and failed to make the information public.

On 11 February 2002, the actuarial report for the retirement system was issued to SDCERS senior staff and Board trustees. The report illustrated that the funding ratio for the plan decreased to 89.9 percent, a decline of 8 percent over the previous year.[1]
The timing was critical because the decline in the funded ratio – the amount of assets held by the SDCERS trust in comparison to the money owed – was moving the City dangerously close to breach of a contract with SDCERS approved in 1996, called Manager's Proposal I (MP I).

According to MP I, a funding floor of 82.3 percent was established as a trigger. If the City fell below that funding level, a one-time lump sum payment would be required to return the funded ratio to that level. The pension plan's funding level fell from 97.3 percent as of 30 June 2000; to 89.9 percent as of 30 June 2001.[2]

Early in 2002, City officials became alarmed that the trigger might be hit and discussed the potential costs of paying the full actuarial value into the pension – an estimated increased

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[1] San Diego City Employees Retirement System Annual Actuarial Valuation June 30, 2001. (Exhibit 1)

[2] 14 June 2002 Memorandum from Cathy Lexin to Mayor and Council p. 2. (Exhibit 2)

cost of $25 million annually.[3] In a city where the annual general fund budget hovers between $800 million and $850 million making a payment of that magnitude was a reality that seemed politically untenable to bring to the public.

Instead of adopting a position of full disclosure, City officials embarked on a long and convoluted plan to cover up the growing debt, and pursued a deal with the SDCERS Board to remove the trigger in exchange for granting increased pension benefits to City employees and retirees. San Diego City officials began to work on a method to avoid the lump sum payment to the retirement system and saw an opportunity with the upcoming contract negotiation with the City's labor unions. The contract negotiation process is also known as "meet and confer."

Meet and confer begins with the negotiating team – typically made up of members of the City's Human Resources Department and representatives of the City Manager's office – meeting with the City's labor union officials to discuss new contracts for employees. The City's negotiating team comes up with offers and strategies. These strategies are then presented to the Mayor and City Council, in Closed Session, who must approve them at each step of the negotiations.

The negotiating team then conducts discussions with the labor unions.
The process typically begins in March and continues until the budget is approved by the City Council at the end of the fiscal year.

The first meeting with the negotiating team occurred on 26 February 2002.[4] The Mayor and City Council members in this meeting authorized the team to offer a multi-year agreement with labor unions that included increased salaries and pension benefit packages.

[3] 16 April 2002 Closed Session Presentation, Slide 17. (Exhibit 3)

The City Attorney's Interim Reports I and II provide evidence showing that throughout closed session meetings in March 2002, the City Council learned of the declining financial health of the pension fund, the "trigger," and the dangers of a potential balloon payment during meeting with the negotiating team.

As presentations of the financial crisis were being delivered to the City Council, the information also circulated throughout the SDCERS leadership. Lawrence Grissom, administrator of SDCERS, was aware that the retirement system was dangerously close to the trigger and realized that any benefit enhancements granted to City employees in the negotiations might increase SDCERS liabilities and fall below the trigger. Grissom explained in an e-mail on 6 March 2002.[5] The City's labor negotiating team continued to stress the dour financial news to the City Council in meetings on the meet and confer process through March 2002.

City staff told Mayor Dick Murphy and City Council members at the closed session meeting on 18 March 2002 that the municipality is coming dangerously close to 82.3 percent trigger.[6] At this point, information had been presented to the City Council and SDCERS officials that a real danger of violating the trigger was apparent. The suggested solution was to ask the SDCERS trustees to remove the trigger in exchange for increased retirement benefits for City employees.

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[4] 21 February 2002 Closed Session Agenda Items for 26 February 2002 "Conference with Labor Negotiator, pursuant to Government Code Section 54957.6: Agency negotiations: Michael Uberuaga, Lamont Ewell, Cathy Lexin, Dan Kelley, Stanley Griffith, Mike McGhee; Employee organizations: Municipal Employees Association, Local 127 AFSME, AFL-CIO, Local 145 International Association of Firefighters AFL-CIO, San Diego Police Officers Association (Exhibit 4)

[5] 6 March 2002. E-mail from Lawrence Grissom to Terri Webster. Cc'd: Cathy Lexin and Ed Ryan, former city auditor and comptroller. (Exhibit 5)

[6] 15 March 2002. Memo from Dan Kelley to Mayor Dick Murphy and City Council. Re: Closed Session Meet and Confer Materials for 18 March 2002 meeting. (Exhibit 6)

The City Council, in the 16 April 2002 closed session meeting, authorized the City's team to negotiate a series of benefit increases for employees and included one special caveat: "Condition all retirement enhancements on removal of the 'trigger' in the Managers Proposal regarding CERS funding ratio". Mayor Murphy and the City Council members were also told that falling below the trigger could require the City to pay an extra $25 million annually to SDCERS.[7]

In the succeeding months, the City's labor negotiations team had continued to meet with labor officials and map out a series of benefit improvements that included special benefit increases for high level officials.

The Mayor and Council at the 29 April 2002 closed session meeting approved 10 employee benefit improvements. On nine of the adjustments, the vote was 9-to-0.[8]
The vote to retroactively increase a key retirement multiplier in the formula passed 8-to-1, with Council member Donna Frye in opposition. Specifically, the multiplier was increased from 2.25 percent for retirement at 55-year-old, to 2.5 percent at age 55.[9]

The next day, on 30 April 2002, the City Council unanimously approved (9-0) a special benefit that would allow Judie Italiano, president of the San Diego Municipal Employees Association, and Bill Farrar, president of the San Diego Police Officers Association, access to the City's pension program despite not officially being City employees.[10] One week later, on 6 May 2002, the City Council approved allowing Ron Saathoff, president of the San Diego

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[7] 16 April 2002 Closed Session Presentation (Exhibit 7)

[8] 29 April 2002 Closed Session report. (Exhibit 8)

[9] 29 April 2002 Closed Session report. (Exhibit 8)

[10] 30 April 2002 Closed Session Meeting minutes. (Exhibit 9)

Firefighters Association 145 and trustee to SDCERS, inclusion in the City's pension fund on a 9-0 vote.[11]

At this point, the City had set the stage and conditionally approved a set of benefits enhancements that would only be ratified and implemented by the City Council if the SDCERS Board lowered the trigger to allow for the under funding of the pension system. The contingent nature of this deal was made clear on 9 May 2002, when City Manager Michael Uberuaga appeared before the SDCERS Board seeking the reduction of the trigger from 82.3 percent to 75 percent. According to testimony from Pension Trustee Diann Shipione, Uberuaga specifically said that the benefit improvements were contingent on the SDCERS reduction of the trigger.[12]

The lowering of the trigger would basically allow the City to pay less into the SDCERS and cause the system's financial security to decline. The offer posed a series of ethical questions to the Board. There were two issues that ultimately jumped out to SDCERS officials and later their fiduciary and legal adviser about the legality of the deal:

1. Is it appropriate to have City employees who would eventually receive City pensions negotiating the benefit levels?
2. Is it appropriate to have City employees who also serve as trustees on the SDCERS Board vote on items that clearly impact their eventual pension packages, and does this monetary interest represent a conflict of interest?

Eventually Government Code 1090 and the California State Political Reform Act of 1974 were discussed. Both of these issues are addressed later in this report.

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[11] 6 May 2002 Closed Session Meeting Minutes. (Exhibit 10)

[12] 28 November 2005 and 29 November 2005. Diann Shipione testified in Superior Court as a witness in U.S. District attorney vs. Ronal Saathoff et al.

The Board was also facing another serious ethical issue by removing a trigger that was designed to protect the fiscal health of the system. Such an action might result in a breach of the Board's fiduciary duty to the trust. When a trustee takes a position on the board, his or her top priority is to ensure the solvency and financial health of the retirement system so that retirees continue to receive checks.[13]

The City's retirement Board, at the time of Uberuaga's first appearance, was composed of 13 members: a representative of the City Manager, the City Auditor and Comptroller, the City Treasurer, three members elected by the active general membership, one member elected from City retirees, one member elected by the active membership from Fire Safety, one member elected by the active membership from Police Safety, and four citizens appointed by the Mayor and City Council, one of who had to be a local bank officer. The Charter prescribed six-year terms for Board members.

The mayor's appointments included local developer Frederick Pierce IV; Richard Vortmann, president of NASSCO; Diann Shipione, a senior financial officer for UBS Financial Services; and Ray Garnica, filling the seat designated for a local bank officer. The City Manager appointed Cathy Lexin, the City's director of human resources; the office of the City Auditor was represented by Terri Aja Webster, assistant city auditor and comptroller; and City Treasurer Mary Vattimo represented that office. The San Diego Firefighters IAFF Union, Local 145,

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[13] Article 16 California State Constitution Section (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...
(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.

elected Ron Saathoff, president of the organization; the San Diego Police Officer's Association elected Tom Rhodes, a San Diego Police lieutenant. The three Municipal Employees' Association appointments were Sharon Wilkinson, John Torres, and John Casey. The elected retiree representative on the Board was David Crow.

III.

NEW DOCUMENTS

On 6 June 2002, City Manager Uberuaga returned to the SDCERS Board and submitted another proposal for the reduction of the trigger. He explained that the City's financial hardship stemmed from an economic slowdown resulting from the terrorist attacks in New York City on 11 September 2001, and the subsequent stock market crash.[14] SDCERS Administrator Larry Grissom issued a memo on 13 June 2002, describing Uberuaga's proposal, specifically pointing out the contingent nature of the benefit increases in return for trigger removal. Grissom wrote:

> Here's a cover for the manager's proposal revision…As a result of this year's meet and confer process, agreement has been reached on certain enhancements to retirement benefits for general member…All of these changes are contingent upon the Retirement Board's approval of modifications to the 1996 Manager's Proposal.[15]

The agreement, however, did not initially gain the support of the SDCERS' outside fiduciary counsel. On 21 June 2002, Bob Blum issued a draft opinion that included 47 reasons why Manager's Proposal II was not a good deal for the City. The opinion, however, was never signed and made official.[16] Rick Roeder, the system's actuary, also submitted a letter to the Board outlining his opposition to the proposal.[17]

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[14] Vinson and Elkins Report, issued on September 16, 2004, p. 83. (Exhibit 11)

[15] 13 June 2002. E-mail from Lawrence Grissom to Sally Zumalt. Re: cover memo. (Exhibit 12)

[16] Vinson and Elkins Report, issued on September 16, 2004, p. 84-88. (Exhibit 13)

A proposal to alter the City's contribution to the retirement system and lower the trigger was heard by the SDCERS Board at a specially scheduled meeting on 11 July 2002. The Board approved a modified version of Manager's Proposal II that permitted a lower annual payment from the City but kept the trigger in place.[18] Pension Trustee Diann Shipione asked that the Board request another legal opinion regarding conflict of interest violations and Garnica required written indemnification for the issue, according to an unsigned hand written account of the meeting.[19] Neither of these two requests was approved at the meeting. While the Board passed a portion of the deal, the 82.3 percent trigger was still in place which left the City liable for the lump sum payment. Therefore, the enhanced benefits package would not gain the approval of the City Council. One roadblock stood before the full passage of Manager's Proposal II and the lowering of the trigger: Rick Roeder never approved the SDCERS 11 July 2002 agreement.[20]

In the ensuing months, Blum applied significant pressure on Roeder to sign a more definitive opinion. Blum updated Grissom on 14 September 2002:

> i am working on an opinion letter. it wont be done for circulation by the board meeting. it is highly dependant on what rick will say in writing and i am trying to find words that will both give him comfort and give the board what it needs.[21]

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[17] Vinson and Elkins Report, issued on September 16, 2004, p. 84-88. (Exhibit 13)

[18] 11 July 2002. San Diego City Employees Retirement System Board Minutes for Thursday, July 11, 2002. (Exhibit 14)

[19] 11 July 2002. Handwritten note. The note was part of 60,000 documents formerly-protected by the attorney client privilege made public by SDCERS. (Exhibit 15)

[20] Vinson and Elkins Report, issued on September 16, 2004, p. 84-88. (Exhibit 13)

[21] 14 September 2002. Robert Blum to Loraine Chapin, Lawrence Grissom, Paul Barnett. Re: pardon me. (Exhibit 16)

Meanwhile, the City was moving forward. The City Council approved by a vote of 9-to-0 the series of benefit increases that had been part of the deal at the 21 October 2002 open session meeting.[22] It was now up to the SDCERS Board to approve the agreement to lower the trigger from 82.3 percent to 75 percent, thereby releasing the City from the key provision of MPI and paving the way for further underfunding of the pension system. After that, the City would grant its final approval for the benefit increase to solidify and complete Manager's Proposal II.

The City began to apply pressure on the Board to approve the deal and ensure that the City would not be faced with the balloon payment. Robert Blum expressed his frustration about added pressure from the City to both change the deal and speed up the process. At one point, Blum asked for increased leeway to negotiate SDCERS' interests with more strength.

> i have sent you mike rivo's email w/ my reply on the city's newest desire [sic] drop dead date of dec 1 for the city to be told the funding ratio if the trigger is to be pulled for the next fy.
>
> also, i am concerned about the fact that this would put the city's properties first among all other (unknowable at this time) priorities of the board. that is a fiduciary problem.
>
> finally, you will appreciate that when rivo raised this issue, it seemed to me that all restraints had been eliminated on raising new issues…
>
> please, please, oh please unleash me in the next go round w/rivo. i want him to know that if the city continues to raise the ante, we will do the same.[23]

Grissom's reaction to the City's request to force an earlier date reflected his discontent and also illustrated a significant loss of control by SDCERS. Grissom wrote:

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[22] Minutes of the Council of the City of San Diego for the Regular Meeting of Monday, Oct. 21, 2002. (Exhibit 17)

[23] 23 October 2002. Robert Blum to Lorraine Chapin, Lawrence Grissom, and Paul Barnett. Re: rivo's email. (Exhibit 18)

> …my first reaction is %^%^$&*^)&*_ to put it mildly. It may seem like a minor issue on the surface, but it is to me yet another example of what is becoming a significant power struggle.[24]

As Grissom tried to work through the problem with the City officials, Blum turned his attention back to Roeder seeking his support for the deal. Blum had been writing a letter of support for lowering of the trigger that was supposed to be signed by Roeder. Blum sent an e-mail to Roeder that included a draft on 29 October 2002, requesting Roeder's signature. Blum wrote:

> we are finished negotiating w/ the city re the agreement. a copy of the version that will go to the board is attached. (the examples were worked out w/ larry.) remember the letter we need from you? we now need to have it signed. a copy is attached.[25]

Roeder, however, still had some clear reservations about signing the letter and stressed that he had not "signed off" on the most recent Manager's Proposal. Roeder wrote:

> Hmmmmm, thinking about this, I do not want to have anybody think that we advocate a method, which, in total, would have over a decade of subsidized rates.[26]

Blum was not satisfied with Roeder's answer and sent back what may be considered a veiled threat.

> You had signed off on this exact language before. so lots of people would be very unhappy if you are unwilling to sign off on it now.[27]

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[24] 24 October 2002. Lawrence Grissom to Robert Blum, Lorraine Chapin, and Paul Barnett. Re: rivo's email. (Exhibit 19)

[25] 29 October 2002. Robert Blum to Rick Roeder. Re: your letter for sdcers. (Exhibit 20)

[26] 29 October 2002. Rick Roeder to Robert Blum, Lorraine Chapin, Lawrence Grissom, Paul Barnett. Re: your letter for sdcers. (Exhibit 20)

[27] 30 October 2002. Bob Blum to Rick Roeder, Lawrence Grissom, Paul Barnett, Lorraine Chapin, Connie Hiatt. Re: your letter for sdcers. (Exhibit 21)

This, apparently, was all it took for Roeder and he agreed to sign:

I can live with the language just not optimum. No huge deal at my end.[28]

Blum immediately sent confirmation that Roeder had agreed to Lawrence Grissom who simply replied, "good."[29] The final letter, signed by Roeder[30], appeared before the SDCERS board on 15 November 2002.

Just three days later, the final benefits package was considered by the San Diego City Council. Accompanying the proposal were two letters supporting the deal, one from fiduciary counsel Robert Blum and another from actuary Rick Roeder. The City Council approved the benefit improvement by a vote of 8 to1, with Council member Donna Frye opposed.[31]

In early January 2003, a pair of City retirees, David Gleason and James Wood, were concerned about the warnings that Diann Shipione had been making regarding Manager's Proposal II. Gleason and Wood hired local pension attorney Michael Conger, who filed a lawsuit against the City on 16 January 2003.[32] The suit alleged that the City had violated San Diego City Charter section 143 and San Diego Municipal Code section 24.0801 by underfunding the pension system. The suit also named individual trustees of the SDCERS Board as defendants including Ron Saathoff, Mary Vattimo, Terri Aja Webster, and Cathy Lexin. The suit claimed the

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[28] 30 October 2002. Rick Roeder to Robert Blum. Re: your letter to sdcers. (Exhibit 22)

[29] 30 October 2002. Lawrence Grissom to Robert Blum. Re: your letter to sdcers. (Exhibit 22)

[30] 7 November 2002. Letter from Rick Roeder to Larry Grissom. Re: Agreement Regarding Employer Contributions Between the City and SDCERS. (Exhibit 23)

[31] 18 November 2002. The City of San Diego Minutes doe Regular Council Meeting. (Exhibit 24)

[32] Vinson and Elkins Report, issued on September 16, 2004, p. 97-98. (Exhibit 25)

individual trustees violated state conflict of interest laws and also failed to disclose their financial interest in the deal.

The executive staff at SDCERS began looking for an outside legal defense team for representation in the matter and found San Diego-based law firm Seltzer Caplan McMahon Vitek ("Seltzer"). The firm was officially hired by the Board on 12 February 2003.[33] Seltzer immediately began working on a defense strategy for the litigation. What the firm came up with would eventually stall the release of the documents to the public and investigators for three years. Sheila Leone wrote:

> I spoke with Reg Vitek this morning. The present strategy is to stress that importance of privilege and non-waiver of privilege, with the idea that the attorneys for the City, Retirement System and Board members will meet and decide how best to proceed.[34]

The case proceeded as Seltzer strategized the defense and Michael Conger continued to collect information about how the plan was formed, who the key individuals were in the drafting, and how the plan was approved. Seltzer delivered its initial review and evaluation of the actions taken by SDCERS pertaining to Manager's Proposal II on 5 March 2003. The firm opined that members of the retirement Board had breached their fiduciary duty by adopting the proposal and had also violated conflict of interest codes.

> The Individual Defendants breached their fiduciary duty by adopting the '02 Proposal in its modified form because it resulted in a lower contribution obligation of the City, as well as an increase in vested liabilities…

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[33] 12 February 2003. Letter from Reginald Vitek to Lawrence Grissom and Loraine Chapin. Re: James F. Gleason, et al. v. San Diego City Employees' Retirement System, et al. (Exhibit 26)

[34] 19 February 2003. Sheila Leone to Larry Grissom. Cc'd: Lorraine Chapin, Paul Barnett, and Roxanne Parks. Re: Gleason. (Exhibit 27)

> The Individual Defendants subordinated SDCERS' interests to the interests to themselves, their unions, and the City.[35]

The Board was also advised to create a subcommittee to make key decisions about the litigation in the Gleason case because some of the Board members had conflicts of interest.

Seltzer believed that a group of individuals should be appointed to make key decisions regarding the litigation. Specifically, a committee would advise whether the Board should settle.[36]

Seltzer also advised that the SDCERS Board vote to nullify Manager's Proposal II and go back to Manager's Proposal I.

> SDCERS Staff should recommend to the Board that it exercise its right under the November 18, 2002 Agreement to "nullify this Agreement to the extent required by its duties established under the California Constitution…[37]

The same suggestion was later made by Conger in a conversation with Michael Leone. Following that discussion Michael Leone wrote an e-mail to Sheila Leone stating:[38]

> Conger also told me what he wants is for the Board to exercise the "nullification" clause in the November 18, 2002 Agreement.[39]

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[35] 5 March 2003. Seltzer Caplan McMahon Vitek opinion. Re: San Diego Employees' Retirement System, et al. adv. James F. Gleason, et al. – Initial Litigation Evaluation and Recommendations. (Exhibit 28)

[36] 5 March 2003. Seltzer Caplan McMahon Vitek opinion. Re: San Diego Employees' Retirement System, et al. adv. James F. Gleason, et al. – Initial Litigation Evaluation and Recommendations. (Exhibit 28)

[37] 5 March 2003. Seltzer Caplan McMahon Vitek opinion. Re: San Diego Employees' Retirement System, et al. adv. James F. Gleason, et al. – Initial Litigation Evaluation and Recommendations. (Exhibit 28)

[38] 7 March 2003. Michael Leone to Sheila Leone. Re: Gleason Update. (Exhibit 29)

[39] 7 March 2003. Michael Leone to Sheila Leone. Re: Gleason Update. (Exhibit 29)

The Board, however, would not have an opportunity to vote on the matter until the 26 March 2003 meeting.

Reg Vitek held a meeting with the SDCERS outside fiduciary attorney Bob Blum on 24 March 2003, and unveiled a set of polarizing pieces of information. During discussion, Blum said that during the process leading up to the approval of Manager's Proposal II he was kept out of the loop on certain benefit enhancements and he was pressured by Grissom and other outside consultants to change his opinions.

Vitek discussed the meeting with Sheila Leone. She immediately sent an e-mail to SDCERS officials to update them. Leone wrote:

> Bob was shown Ron [Saathoff]'s 'presidential leave' benefit. He called it 'absolutely breathtaking', said he had no knowledge of it and concluded the existence of the benefit could invalidate the entire manager's proposal. This, obviously, is huge.[40]

Blum said in the interview that he was under significant pressure from Lawrence Grissom to render specific opinions to the Board. Leone wrote:

> Bob was apparently very candid that approval of the benefits was 'absolutely tied' to the Board's vote on the manager's proposal. He said that his June letter (against the deal) was written because Larry told him to 'kill the Manager's Proposal.' For whatever reason, Larry changed his mind. Then, according to Blum, there was enormous pressure to 'make it happen.'[41]

Blum also said that Grissom pressured him to pressure Roeder to give an opinion favorable to Manager's Proposal II at the 18 November 2002 City Council meeting. Leone wrote:

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[40] 24 March 2003. E-mail from Shelia Leone to Loraine Chapin. Cc'd to Roxanne Parks. Re: Blum Meeting. Do Not Forward. (Exhibit 30)

[41] 24 March 2003. E-mail from Shelia Leone to Loraine Chapin. Cc'd to Roxanne Parks. Re: Blum Meeting. Do Not Forward. (Exhibit 30)

> Blum contends he wrote Roeder's letter at Larry's insistence (frankly disturbing). Blum's opinion changed because it's what Larry wanted – not – by the way a solid legal defense.[42]

The discussion in the e-mail then turns to a Board meeting in March where Grissom approached Reg Vitek discussing "side deals" with president of the firefighters union Ron Saathoff, who was also a Board trustee. Describing the conversation, Leone wrote:

> In any event, after the meeting Larry told him 'there's a lot more side deals' than that concocted by Ron. Reg was adamant – he needs to know what Larry is talking about.[43]

In the meantime, the SDCERS staff sought to keep information and discussion about the litigation to an absolute minimum. Fred Pierce went so far as asking that a gag order be imposed on all members of the Board.[44]

Another campaign to minimize information leaks was underway. The City of San Diego was responsible for paying the legal fees of the SDCERS attorneys, but Grissom and Leone undertook an effort to strike out the majority of details from the Seltzer bills to the City. The goal was to ensure that information about what the firm was working on would not be disclosed. Grissom and Leone agreed that redacting the details of the bills was the best method of keeping

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[42] 24 March 2003. E-mail from Shelia Leone to Loraine Chapin. Cc'd to Roxanne Parks. Re: Blum Meeting. Do Not Forward. (Exhibit 30)

[43] 24 March 2003. E-mail from Shelia Leone to Loraine Chapin. Cc'd to Roxanne Parks. Re: Blum Meeting. Do Not Forward. (Exhibit 30)

[44] 12 March 2003. Lawrence Grissom to Loraine Chapin and Roxanne Story Parks. Re: Gleason/Diann. (Exhibit 31)

information about their work for SDCERS secret.[45] They agreed to work with Terri Webster, assistant city auditor and also a trustee to SDCERS, to ensure that this happened "efficiently."[46]

Despite the condemning legal opinion from the SDCERS outside legal counsel, the Board failed to take action to correct what they had done. At the SDCERS Board meeting on 25 March 2003, the Board failed to nullify the underfunding deal, an action recommended by both SDCERS counsel and the plaintiffs' attorney. Shipione sent a letter to Grissom after the meeting explaining the votes.[47]

> I moved the board appoint the non-defendant sub committee. I also moved the second recommendation by Mr. Vitek that the back-loading agreement be revoked.
>
> The Board voted to keep the litigation decision making with the whole board, and my second motion to revoke the back-loading agreement failed for lack of a second.[48]

Important policy decisions of the Board were being made in direct contradiction of advice given by Seltzer. First, the Board agreed to keep the agreement in place, despite the 5 March 2003 Seltzer opinion that in approving the deal the Board members violated their fiduciary duties. Second, the Board voted to create a litigation subcommittee to advise on the Gleason litigation, but kept the final decision-making on the litigation with the Board.

The Board then began its search for an outside attorney that could advise on the Gleason litigation. Vitek was dissatisfied with the Board's failure to grant the subcommittee complete

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[45] 13 March 2003. E-mail from Grissom to Sheila Leone. Re: Seltzer Billing. (Exhibit 32)

[46] 13 March 2003. E-mail from Grissom to Sheila Leone. Re: Seltzer Billing. (Exhibit 32)

[47] 26 March 2003. Letter from Diann Shipione to Lawrence Grissom. (Exhibit 33)

[48] 26 March 2003. Letter from Diann Shipione to Lawrence Grissom. (Exhibit 33)

control over the litigation and in a 2 April 2003 letter, threatened to resign as counsel to SDCERS in the Gleason litigation.

> We genuinely regret we are unable to continue in the representation of SDCERS; however, we feel it would be professionally irresponsible for us to do so under circumstances where we would be taking direction in this very serious litigation from individual defendants who not only have demonstrated a willingness to subordinate SDCERS' interests to the interests of other persons or entities (including themselves, but who, in addition, have conflicts of interests created by the litigation itself.[49]

SDCERS in-house attorneys then turned to Bob Blum and Connie Hiatt for an opinion regarding the need for an independent subcommittee to handle the litigation. After a discussion with SDCERS general counsel Loraine Chapin, Blum and Hiatt agreed with the Seltzer Caplan opinion, a circumstance that would later change:

> After a fair amount of discussion, they came back to, the Board really should delegate to a third party . . . They [Bob and Connie] felt this would insulate both Rej and the Board from future beneficiary generated suits based on representation of a conflicted board.[50]

The Board hired the law firm Hillyer Irwin to advise on how much power to give to the subcommittee to allow Seltzer to return to the job. David Hopkins, an attorney with Hillyer Irwin, sent an e-mail to a Board member on 17 April 2003, stating that only partial authority should be given.[51] The SDCERS Board of directors met on 18 Friday 2003 and decided that a

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[49] 2 April 2003 letters from Reg Vitek to Lawrence Grissom and Loraine Chapin. Re: James F. Gleason, et al. v. San Diego City Employees' Retirement System, et al. (Exhibit 34)

[50] 8 April 2003. E-mail from Loraine Chapin to Roxanne Parks and Sheila Leone. Re: Trustee ad litem (TAL). (Exhibit 35)

[51] 17 April 2003. E-mail from David Hopkins to Terri Webster. Re: Gleason Case Update and 4/18 meeting agenda. (Exhibit 36)

litigation subcommittee should be formed to provide advisory assistance to the Board on litigation issues.[52]

The Board voted on 24 April 2003 to hire Washington DC-based fiduciary advisor, Nell Hennessy. As a result Reg Vitek and Seltzer returned as lead counsel to SDCERS in the Gleason litigation.[53]

During this time frame, the number of depositions taken in the case had increased. In preparing for his own deposition, Lawrence Grissom gives one of the most in-depth descriptions of what was happening at the SDCERS Board of administrators when Manager's Proposal II was being drafted. Specifically, he speaks about the "greed" and recklessness of Board members. In the 12 September 2003 e-mail, Grissom wrote to Michael Leone:

> Both labor and management adopted an attitude of not caring about the costs of benefits, because the liability 'can just be rolled into the Manager's Proposal'. Greed happened. Long discussion about too many labor and management reps on retirement Boards…
>
> Manager's Proposal II was not handled nearly as well as the first one. The City's position was to say, new benefits, which we will pay for, but we see the train coming down the track and we need to shore up our downside protection (reduce floor). Their approach was <u>if I give you this, you gotta give me that</u> – carried out in pretty roughshod manner…
>
> It still galls me that the beneficiaries whom we have all taken the holy oath to protect didn't give a damn about anything but their benefit enhancements…[54] [emphasis added]

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[52] 21 April 2003. E-mail from Dick Vortmann to Fred Pierce. Re: Litigation Representative. (Exhibit 37)

[53] 24 April 2003. E-mail from Lawrence Grissom to Fred Pierce. Cc'd to Loraine Chapin and Paul Barnett. Re: litigation consultant. (Exhibit 38)

[54] 12 September 2003. E-mail from Lawrence Grissom to Michael Leone. Cc'd: Loraine Chapin, Paul Barnett, and Sheila Jacobs. Re: Justification. (Exhibit 39)

When Sheila Jacobs heard that trustee Cathy Lexin was going to be deposed, she sent an e-mail to Roxanne Parks about what information could be disclosed. Jacobs wrote in a 13 January 2004 e-mail:

> Roxanne, (Do not share this with anyone.) Cathy Lexin is going to be deposed soon. She is going to testify that she essentially wrote MPII.[55]

Parks was unclear on what portion of the Manager's Proposal II deal was being discussed and unveiled another condemning piece of information implicating specific Board members. Parks wrote in the 13 January 2004 e-mail:

> The benefits or the funding agreement?? I know she was the architect of the benefits, along with other Board members (Ron [Saathoff] and Terri [Webster])[56]

The deposition of Robert Blum was also one of the most important and further illustrated potential problems for SDCERS. In an e-mail from Vitek to Michael Leone and Sheila Jacobs on 29 January 2004, key facts are illuminated about what Blum said. Specifically, Blum testified that neither he nor Connie Hiatt looked at the City Charter Section or Section 1090 – both outlining conflict of interest law – before issuing an opinion. Other important facts include:

> 2. Blum's 11/18 signed opinion omits 47 facts (regarding financial impact of MP2) which were included in the 6/12/02 draft opinion. (Neither Blum nor Hiatt had any recollection why they were omitted.)
>
> 3. The 11/18 opinion omits Footnote 1 of the 6/12/02 draft which says that, if the trigger is hit, the City would have to infuse $75 million.[57]

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[55] 13 January 2004. E-mail from Sheila Jacobs to Roxanne Story Parks. Re: Interesting. (Exhibit 40)

[56] 13 January 2004. E-mail from Sheila Jacobs to Roxanne Story Parks. Re: Interesting. (Exhibit 40)

[57] 29 January 2004. E-mail from Reg Vitek to Michael Leone. Cc'd: Sheila Jacobs. Re: Hanson Bridgett depositions. (Exhibit 41)

Sheila Jacobs responded to Vitek's e-mail and addressed some of the issues that Blum discussed:

> I was present at meetings in which Bob Blum told the Board 'all was fine' if they 'thought really hard.' I also know he was assigned to work with the City Attorney to come up with something that would sell to the Board on MPII. Not once did he ever suggest that was contrary to his ethical duties. Roxanne and I were pretty much shocked.[58]

Jacobs and Parks again turn to each other to vent on some of the problems that are coming out of the depositions. Roxanne Parks wrote an e-mail on 30 January 2004 blasting Blum for not telling the truth in his deposition. Parks wrote:

> What a flippin' weasel!!! His depo gives me a stomach ache especially the part about not having or recalling any opinion on what would happen under MPI if we crashed through the floor, which we did…[59]

This e-mail indicates that the Board or the senior staff at SDCERS was presented with information about the impact of a trigger violation and how that would affect the financial health of the trust.

At this point, Jacobs begins discussions with Seltzer about suing Blum's firm, Hanson Bridget Marcus Vlahos & Rudy. Discussions of this had been occurring between attorneys and executive staff for months. Grissom, however, seems to not be on Board with this line of action, according to an e-mail from Sheila Jacobs:

> Do you plan to mention that the Board may want to consult a malpractice attorney this month? I am asking because although I sent an email to Larry, Paul and Lori after Blum's depo telling them not to continue to use Blum for advice, Larry is still calling him and getting 'draft' email opinions. I think he may be damaging

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[58] 29 January 2004. E-mail from Sheila Jacobs to Reg Vitek. Re: Hanson Bridgett depositions. (Exhibit 42)

[59] 30 January 2004. E-mail from Roxanne Parks to Sheila Jacobs. Re: Blum Rough Ascii. (Exhibit 43)

> the board's claim…Larry may be doing this deliberately because he does not want to sue Blum.[60]

Despite the fact that members of the SDCERS executive staff and the attorneys at Seltzer were discussing whether or not to sue Blum's firm, the SDCERS officials commissioned him to issue another legal opinion on possible 1090 violations to the SDCERS Board and clear them of any violations.[61]

Perhaps the most damning piece of information was issued by Michael Leone on 13 May 2004, a follow-up legal opinion regarding the Gleason litigation. In the document, Leone and attorneys at Seltzer Caplan found that individual Board members both violated state conflict of interest code Section 1090 as well as violated their fiduciary duty as trustees of SDCERS:

> A bare probability exists that a court would conclude the Board breached its fiduciary duty by approving Manager's Proposal II…It is probable the Court would conclude the Board's vote to adopt Manager's Proposal II violated Government Code section 1090, thereby invalidating the vote.[62]

More specifically, Leone found that conflict of interest laws may apply because the four defendants failed to disclose their financial interest in the agreement.[63]

Leone specifically pointed out that the "presidential leave benefit" approved for Ron Saathoff would be difficult to defend because it may represent an "individual contract." Leone wrote:

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[60] 16 February 2004. E-mail from Sheila Jacobs to Michael Leone and Reg Vitek. Re: Blum. (Exhibit 44)

[61] 20 February 2004. RAB to MNC. Re: San Diego City Employees Retirement System – Analysis of Conflict of Interest Issue. (Exhibit 45)

[62] 13 May 2004. Seltzer Caplan McMahon Vitek opinion to Lawrence Grissom. Re: James F. Gleason, etc. v. San Diego City Employees' Retirement. P. 2. (Exhibit 46)

[63] 13 May 2004. Seltzer Caplan McMahon Vitek opinion to Lawrence Grissom. Re: James F. Gleason, etc. v. San Diego City Employees' Retirement. P. 27. (Exhibit 46)

> In addition to the failure to comply with the 'disclosure' and 'record' elements of section 1091.5, it appears adoption of this ordinance implicated only Board member Saathoff's interests, and therefore would constitute an 'individual' contract, rather than a contract between two public agencies, such that neither the 'non-interest' or 'remote interest' exceptions could be applied.[64]

Moreover, Leone restated his opinion that it is likely that the contract would be voided as a result of conflict of interest violations.[65]

Leone also found that the benefit enhancements approved by the City Council in 2002 were contingent on the SDCERS Board lowering the trigger from 82.3 percent as established in the 1996 Manager's Proposal I to 75 percent. Leone wrote:

> The evidence is clear that the City promised its unions enhanced retirement benefits, contingent on the Board's adoption of Manager's Proposal II. The evidence is likewise clear that the linkage between enhanced retirement benefits for City employees, and adoption of a new "contribution agreement" was repeatedly emphasized in communications between City labor negotiators and SDCERS Board members.[66]

SDCERS and the City entered into a settlement with the plaintiff in the case in August 2004.[67]

IV.

CONCLUSION

An analysis of several thousand documents released by SDCERS in September 2005 under Federal Court order provides additional evidence illustrating that retirement benefits

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[64] 13 May 2004. Seltzer Caplan McMahon Vitek opinion to Lawrence Grissom. Re: James F. Gleason, etc. v. San Diego City Employees' Retirement. P. 27. (Exhibit 46)

[65] 13 May 2004. Seltzer Caplan McMahon Vitek opinion to Lawrence Grissom. Re: James F. Gleason, etc. v. San Diego City Employees' Retirement. P. 28. (Exhibit 46)

[66] 13 May 2004. Seltzer Caplan McMahon Vitek opinion to Lawrence Grissom. Re: James F. Gleason, etc. v. San Diego City Employees' Retirement. P. 7. (Exhibit 46)

[67] 16 September 2004. Vinson and Elkins' "Report on Investigation." P. 98. (Exhibit 47)

granted by the City Council as part of Manager's Proposal II was part of a quid pro quo arrangement to entice the SDCERS Board to lower the 82.3 percent funding trigger.

The release of the documents also specifically illustrates there is substantial evidence that officials and trustees of SDCERS violated Government Code 1090 and there is also substantial evidence these officers also violated their fiduciary duty to the pension system.

Documents released by SDCERS show there is substantial evidence certain Board members violated their duties as trustees of the pension trust by placing their personal financial interests over maintaining the financial integrity of the pension trust. The violations were then compounded by the SDCERS Board's refusal to correct the illegal acts by keeping Manager's Proposal II in place, until it was made the subject of civil litigation.

The documents released by SDCERS also contain substantial evidence that SDCERS officials withheld key information from the public, the City of San Diego and certain individuals on the SDCERS Board. The City Attorney's Office is currently investigating whether city and SDCERS officials engaged in related obstruction of justice. This inquiry will be the subject of a later Interim Report.

By_____
Michael J. Aguirre
City Attorney