

**INTERIM REPORT NO. 35**

**CITY OFFICIALS RESPONSIBLE**

**FOR GRANTING OF UNLAWFUL PENSION BENEFITS**

**1996 THROUGH 2002**

**REPORT OF THE  
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## **I. BACKGROUND**

San Diego City officials approved an increase in pension benefits without a funding source in 1996 which created an immediate City debt without the vote of the public. Under the State Constitution's debt limitation law<sup>1</sup> and the City Charter, a public vote is required in order to create a new debt.<sup>2</sup>

The City officials that voted to approve the retirement benefits without a funding source also had a financial interest in the increased pension benefits they granted to themselves and other City employees. This constitutes a violation of the State law<sup>3</sup> and City Charter<sup>4</sup> prohibitions that do not permit City officials to consummate City contracts in which the officials have a financial interest.

Such contracts and debts are void under the Charter and State Constitution and laws.

The City officials who incurred the debt without a vote and participated in making the 1996 the pension contracts in which they held a prohibited financial interests included but are not limited to the following City and pension officials:

- ✓ Assistant Police Chief, and City Employees Retirement System President Keith Enerson;
- ✓ SDCERS Administrator Lawrence Grissom;
- ✓ City Manager Jack McGrory;
- ✓ City Deputy City Manager Bruce Herring;
- ✓ Assistant City Attorney John M. Kaheny;
- ✓ SDCERS Board member and Fire Fighter president Ron Saathoff;
- ✓ City Labor Relations Manager Cathy Lexin;
- ✓ SDCERS Board Member and City Auditor Terri Webster;

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<sup>1</sup> California Constitution Article 16 Section 17, Article 16 Section 18, Article 16 Section 19. (Exhibit 1).

<sup>2</sup> San Diego City Charter § 99. (Exhibit 2).

<sup>3</sup> California Government Code § 1090. (Exhibit 3).

<sup>4</sup> San Diego City Charter § 94. (Exhibit 4).

- ✓ Mayor Susan Golding;
- ✓ City Council Member Valerie Stallings;
- ✓ City Council Member Chris Kehoe;
- ✓ City Council Member Barbra Warden;
- ✓ City Council Member Harry Mathis;
- ✓ City Council Member Byron Wear;
- ✓ City Council Member Judy McCarty;
- ✓ City Council Member Juan Vargas;
- ✓ SDCERS Member Sharon Wilkinson;
- ✓ SDCERS Board Member John Torres; and
- ✓ Deputy City Attorney Lori Chapin;

In September 2000, San Diego City officials again participated in the granting of pension benefit increases in which they had a prohibited financial interest and which created a debt without the vote required under the State Constitution and City Charter. The benefit increases raised the pension benefits for elected officials in office after 12 September 2000 to 3.5% of total monthly compensation.<sup>5</sup> In October 2001, the elected City Attorney was added to the program.<sup>6</sup> The City officials who participated in the granting of the unlawful pension benefits to elected officials included but are not limited to the following persons:

- ✓ City Council Member Harry Mathis;
- ✓ City Council Member Valerie Stallings;
- ✓ City Council Member Byron Wear;
- ✓ City Council Member Chris Kehoe;
- ✓ City Council Member Judy McCarty;

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<sup>5</sup> San Diego City Council Ordinance Number O-18847 (New Series), Adopted on September 12, 2000. (Exhibit 5).

<sup>6</sup> San Diego City Council Ordinance Number O-18994 (New Series), Adopted on October 8, 2001. (Exhibit 6).

- ✓ City Council Member Juan Vargas;
- ✓ Mayor Susan Golding;
- ✓ City Council Member Barbra Warden; and
- ✓ City Attorney Casey Gwinn.<sup>7</sup>

In between May and December 2002 City officials again entered into contracts and created another debt<sup>8</sup> in violation of the City Charter, State Constitution and law. These contract and pension benefit enhancements were also illegal because there was no vote of the people and because the City officials were financially interested in contracts they made in the name of the City. The City officials participating in these violations of law include but are not limited to the following:

- ✓ Deputy City Manager Bruce Herring;
- ✓ Assistant City Attorney Leslie J. Girard;
- ✓ Mayor Dick Murphy;
- ✓ City Council Member Scott Peters;
- ✓ City Council Member Jim Madaffer;
- ✓ City Council Member Byron Wear;
- ✓ City Council Member Toni Atkins;
- ✓ City Labor Relations Manager Daniel E. Kelley,
- ✓ Executive Assistant City Attorney Leslie Devaney;
- ✓ City Human Resources Director and SDCERS Board Member Cathy Lexin;
- ✓ City Manager Michael P. Uberuaga;

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<sup>7</sup> Minutes of the 12 September 2000 meeting of the San Diego City Council. Minutes of the 8 October 2001 meeting of the San Diego City Council. See San Diego City Council Ordinance Number O-18847 (New Series), Adopted on September 12, 2000 and San Diego City Council Ordinance Number O-18994 (New Series), Adopted on October 8, 2001. (Exhibit 7).

<sup>8</sup> San Diego City Council Resolution Number R-2003-1513, Adopted on October 21, 2002. San Diego City Council Ordinance Number O-19126. (Exhibit 8).

- ✓ Head Deputy City Attorney Elmer Heap;
- ✓ City Treasurer and SDCERS Board Member Mary Vattimo;
- ✓ SDCERS Administrator Lawrence Grissom;
- ✓ SDCERS Legal Counsel Lorraine Chapin;
- ✓ SDCERS Board Member Sharon Wilkinson;
- ✓ SDCERS Board Member John Torres;
- ✓ SDCERS Board Member and Fire Fighter Union President Ron Saathoff;
- ✓ City Council Member Ralph Inzunza;
- ✓ City Council Member Brian Maienschien;
- ✓ Deputy City Manager Lamont Ewell;
- ✓ City Attorney Casey Gwinn; and
- ✓ SDCERS Trustee and San Diego City Auditor Terri Webster.

A billion dollar debt that was created as a direct result of the unlawful activities and it remains a financial burden on the people of San Diego.<sup>9</sup> Recent reports have illustrated that the market value of assets for the pension fund have dropped by more than \$1.4 billion since September 2007.<sup>10</sup>

The United States Grand Jury,<sup>11</sup> the United States Securities & Exchange Commission,<sup>12</sup> and the San Diego District Attorney brought legal actions against only a few of the City officials

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<sup>9</sup> San Diego City Employees' Retirement System, Annual Actuarial Valuation, June 30, 2003. (Exhibit 9).

<sup>10</sup> Callan Associates Inc., Investment Measurement Service: Quarterly Review, San Diego City Employees' Retirement System: September 30, 2007, "As of quarter end, the assets of the Fund were valued at \$5,109 million". Callan Associates Inc.; Investment Measurement Service: Quarterly Review, San Diego City Employees' Retirement System: September 30, 2008, "As of quarters end, the assets of the Fund were valued at \$4,297 million". 19 November 2008, "Report to the Special Joint Meeting of the Committee on Budget and Finance and City Council Committee of the Whole," by David B. Wescoe, Administrator/CEO, "Even with the recent downturn, as of October 31, 2008, SDCES has approximately \$3.7 billion of assets..." (Exhibit 10).

<sup>11</sup> January 2004 Grand Jury; United States of America, Plaintiff, v. Ronald Saathoff (1), Cathy Lexin (2), teresa Webster (3), Lawrence Grissom (4), Loraine Chapin (5). July 2007 Grand Jury; United

involved in the alleged illegal actions.<sup>13</sup> No case was brought against the City Council members, Mayors or City Attorneys who participated in the alleged illegal acts.

Instead, the Council members that participated in the alleged unlawful activities were allowed to remain in control of the City Council and their allies were allowed to retained control of the pension plan.

A San Diego Superior Court judge ruled against setting aside the illegal pension debt in December 2006.<sup>14</sup> Also in 2006, the California Supreme Court took up the related state criminal prosecution brought against some of the staff charged with felonies arising out of the illegal pension transactions. It has been stalled in the courts for two years. The federal judge hearing the federal prosecution has cast doubt upon the viability of the federal criminal enforcement action.<sup>15</sup>

The United States Attorney who brought the federal criminal case was forced to resign in January 2007.<sup>16</sup> The whistleblower on the San Diego City Employees' Retirement System Board of Trustees, Diann Shipione, was removed from her position by former Mayor Dick Murphy,<sup>17</sup>

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States of America, Plaintiff, v. Ronald Saathoff (1), Cathy Lexin (2), Teresa Aja Webster (3), Lawrence Grissom (4), Loraine Chapin (5), Defendants (Exhibit 11).

<sup>12</sup> Securities and Exchange Commission in the Matter of City of San Diego, California; Order Instituting Cease-And-Desist Proceedings, Making Findings, and Imposing a Cease-And-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934. Securities and Exchange Commission, Plaintiff, vs. Michael t. Uberuaga; Edward P. Ryan,; Patricia Frazier; Teresa A. Webster; and Mary E. Vattimo, Defendants; Complaint For Violations of the Federal Securities Laws. (Exhibit 12).

<sup>13</sup> 17 May 2005, People of the State of California, Plaintiff, v. Cathy Lexin, Ronald Lee Saathoff, John Anthony Torres, Mary Elizabeth Vattimo, Teresa Aja Webster, Sharon Kay Wilkinson, defendants. (Exhibit 13).

<sup>14</sup> Tentative ruling for 6/23/2006, Department 69, the Honorable Jeffery B. Barton presiding, Case Number GIC8418845; Vigil, Jennifer; "Aguirre appeals his pension case"; *San Diego Union-Tribune*; 12 January 2007. (Exhibit 14).

<sup>15</sup> Moran, Greg; "Judge in pension case refuses to step down"; *San Diego Union-Tribune*; 17 May 2008. (Exhibit 15).

<sup>16</sup> Thornton, Kelly, and Soto, Onell; "Lam asked to step down | Job performance said to be behind White House firing"; *San Diego Union-Tribune*; 12 January 2007. (Exhibit 16).

<sup>17</sup> Vigil, Jennifer; "Aguirre backs three for S.D. pension board"; *San Diego Union-Tribune*; 28 July 2005. (Exhibit 17).

after she faced arrest by the San Diego City Police Department.<sup>18</sup> In July 2005, the pension board sued the newly elected City Attorney weeks after he took office.<sup>19</sup> The local police union, The San Diego Police Officers Association, sued the newly elected City Attorney claiming extortion.<sup>20</sup> That case was dismissed when the police union was unable to provide any evidence supporting its allegations.<sup>21</sup>

The San Diego City Attorney who brought the only legal action to set aside the illegal pension debt was voted out of office. The new City Attorney has promised to drop the case to set aside the illegal benefits.

## II. ILLEGAL BENEFITS GRANTED

The illegal pension benefits granted by the San Diego City Council in 1996, 2000, and 2002 consisted of the following:

✓ Retroactive Increases in Benefits

There were two rounds of retroactive increases in 1996, 2000, and 2002 to the amount employees earned each year towards their pension. The pensions are paid as a percentage of the employees' highest salary. The percentages paid each year were retroactively increased meaning the amount paid to employees increased for work they had already been paid. The City Council increased the percentage of the highest year salary paid them for their pensions to 3.5% per year.

✓ Purchase of Service Credits

In 1996 the pension benefit increases included a program that allowed City officials to buy up to 5 years pension service credits. City officials were able to

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<sup>18</sup> LaVelle, Phillip J.; "Citizen's arrest of Shipione weighed"; *San Diego Union-Tribune*; 16 December 2004. (Exhibit 18).

<sup>19</sup> Superior Court of the State of California for the County of San Diego: San Diego City Employees' Retirement System, by and through its Board of Administration, Plaintiff, vs. San Diego City Attorney Michael J. Aguirre; The City of San Diego and Does 1-100, Defendants; Case No. GIC 841845; 27 January 2005. Vigil, Jennifer, and Stoltz, Martin; "Pension system sues over benefits in latest legal twist"; *San Diego Union-Tribune*; 30 July 2005. (Exhibit 19).

<sup>20</sup> Powell, Ronald; "S.D. police union sues city over pension"; *San Diego Union-Tribune*; 10 August 2005. (Exhibit 20).

<sup>21</sup> "Several claims dismissed in pension suit filed by POA"; *San Diego Union-Tribune*; 3 November 2005. (Exhibit 21).

increase their pensions as if they had worked an additional 5 years. The City Council Members and other elected officials were also were allowed to buy 5 years even though under term limits they limited to 8 years of compensation. The purchase of service program allowed Council Members and other elected officials to be paid as if they had worked 13 years rather than 8 years for the two terms they were permitted to serve.<sup>22</sup>

### III. ROLE PLAYED BY CITY OFFICIALS RECEIVING ILLEGAL PENSION BENEFITS

#### Manager's Proposal 1 (MP I)

The following individuals participated in the granting of illegal pension benefits in 1996 when Manager's Proposal 1 (MP 1) was adopted.

The three architects of the MP 1 proposal were Mr. Jack McGrory, Mr. Lawrence Grissom, and Mr. Keith Enerson.<sup>23</sup> Mr. McGrory was the San Diego City Manager. Mr. Grissom was the Administrator of the San Diego City Employees' Retirement System (SDCERS). Assistant Police Chief Keith Enerson was the president of the Board of Trustees for the San Diego City Employees' Retirement System. Mr. Enerson was second in command to then Chief of Police Jerry Sanders. Mr. Enerson replaced Mr. Sanders as police chief on April 16, 1999.<sup>24</sup>

Memorandums sent amongst and between the three laid out their plan to increase pension benefits decrease contributions thus leaving a City debt to the pension plan<sup>25</sup> that was not

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<sup>22</sup> See Footnotes 5, 6, 7 and 8.

<sup>23</sup> 29 February 1996; e-mail from Jack McGrory, San Diego City Manager, to "Distribution"; Subject: "Retirement"; Please note in e-mail, "Pls provide comments ASAP. I meet with Keith [Enerson] and Larry [Grissom] on Tuesday." (Exhibit 22).

<sup>24</sup> San Diego Police Historical Association:  
[http://www.sandiegopolicemuseum.com/SDPD/Top%20Cops/Jerry\\_Sanders.htm](http://www.sandiegopolicemuseum.com/SDPD/Top%20Cops/Jerry_Sanders.htm). (Exhibit 23).

<sup>25</sup> See Footnote 23. 1 March 1996 memorandum from Keith Enerson, president of SDCERS Board of Trustees and Assistant Chief of Police, to Larry Grissom, Administrator of SDCERS: Subject: "Proposed Retirement Package". (Exhibit 24).

approved by vote of the public as required by the City Charter and State Constitution.<sup>26</sup> Moreover, all three had a financial interest in the benefits being created without a vote of the public in violation of the City Charter and California Government Code § 1090 which prohibits officials from making contracts on behalf of the City in which they are financially interested.

Two San Diego City Attorneys were actively involved in the formulation and consummation of MP I. They were Assistant City Attorney John Kaheny and Deputy City Attorney Sharon Marshall.<sup>27</sup>

Also actively involved in the creation of MP I were San Diego City Deputy City Manager Bruce Herring, City auditor Terri Webster, Labor Relations Manager Cathy Lexin, and Deputy City Attorney Lori Chapin.<sup>28</sup> Mr. Herring and Ms. Webster were also members of the SDCERS Board and voted in favor of MP I.<sup>29</sup> Ms. Chapin was the attorney for SDCERS and participated as legal counsel in advising the SDCERS board when it participated in establishing MP I.<sup>30</sup>

Also participating in the granting of MP I were SDCERS board members John Torres and Ron Saathoff. Mr. Torres was a representative of the Municipal Employees Association and Mr. Saathoff was the President of the Fire Fighters Union. Both Mr. Torres and Mr. Saathoff have been indicted for felony fraud and felony conflict of interest violations in state and federal courts.

San Diego City Mayor Susan Golding and San Diego City Council members Valerie Stallings Chris Kehoe, Barbra Warden, Harry Mathis, Byron Wear, Judy McCarty, and Juan Vargas also participated and voted on MP I. The Council members were fully informed about the increased benefits and decreased contributions and the agreed to rates for contributions to the pension plan.<sup>31</sup>

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<sup>26</sup> See San Diego City Attorney Interim Report 6; *See Footnote 23*; *See Footnote 25*; 23 July 1996 Memorandum from Cathy Lexin to Larry Grissom, (Exhibit 25).

<sup>27</sup> See San Diego City Attorney Interim Report 6; *See Footnote 26*; 21 June 1996 SDCERS Board Minutes; 27 June 1996 Closed Session Agenda Items for 2 July 1996 executed by John M. Kaheny; and 2 July 1996 Resolution Number R-287582 with Management Proposal for City unions, (Exhibit 26)

<sup>28</sup> See San Diego City Attorney Interim Report 6; 17 May 1996 letter from Ann M. Smith to Cathy Lexin; 19 June 1996 Memorandum from Larry Grissom to Cathy Lexin; 21 June 1996, 9:04 a.m., e-mail from Terri Webster to City-mgr.Ctl. (Exhibit 27)

<sup>29</sup> *See Footnote 27*

<sup>30</sup> *See Footnote 27*

<sup>31</sup> *See Footnote 27*. 24 June 1996 San Diego City Council Adoption Agenda p. 63-64; 25 June 1996 Continued Item No. 208; 28 June 1996 City Manager Jack McGrory Memorandum to Mayor and City

Member of the SDCERS Board raised specific objections to the features of MP I in which benefits were raised without a vote of the people and conditioned on an agreement to reduce contributions.<sup>32</sup>

#### **IV. CITY OFFICIALS BENEFITED FROM THE ILLEGAL PENSION BENEFITS MP I**

The City officials who participated in making the illegal pension contracts and incurring the illegal pension debt in connection with MP I have and continue to benefit from their unlawful conduct because they received the fruits of the unlawful benefits in the form of purchased service credits, retroactive benefits, or participation in the deferred retirement option plan.

SDCERS Board president Keith Enerson retired on 7 December 1999. His annual pension of \$143,013 includes retroactive benefits. His pension violates the Internal Revenue Services (IRS) 415 Limit by \$13,013 annually.

SDCERS Administrator Lawrence Grissom retired in December 2005. He purchased five years of service credits at a price below the correct rate.

City Manager Jack McGrory retired in 1997. His annual pension of \$90,561 includes retroactive benefits.

Deputy City Manager Bruce Herring retired on 31 December 2005. His annual pension of \$174,381 includes retroactive benefits. Mr. Herring's yearly pension violates IRS 415 Limits by \$70,044 annually.

SDCERS member and Fire Fighter president Ron Saathoff retired on 2 July 2003. He purchased 3.579 years of service credits at a price below the corrective rate. His annual pension of \$116,436 includes retroactive benefits.

City Labor Relations Manager Cathy Lexin purchased five years of service credits at a price below the correct rate. Her annual pension of \$67,632 includes retroactive benefits.

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Council regarding Retirement Summary; 21 June 1996 Modification Proposal; 7 June 1996 Retirement Proposal; and 21 June 1996 CERS Fiduciary Counsel Opinion. (Exhibit 28).

<sup>32</sup> 21 June 1996 letter from Dwight Hamilton, fiduciary counsel to SDCERS, to Lawrence Grissom, administrator of SDCERS. 16 July 1996 Memorandum from John Casey to Fiduciary Counsel. (Exhibit 29). *Also see Footnote 27.*

SDCERS Board Member and City Auditor Terri Webster purchased five years of service credits at a price below the correct rate. Her annual pension of \$130,344 will include retroactive benefits.

SDCERS Board Member Sharon Wilkinson purchased five years of service credits at a price below the correct rate. Her annual pension of \$61,152 will include retroactive benefits.

SDCERS Board Member John Torres purchased five years of service credits at a price below the correct rate. His annual pension of \$48,192 will include retroactive benefits.

**V.**  
**ELECTED CITY OFFICIALS BENEFITED FROM THE ILLEGAL PENSION BENEFITS**

On 12 September 2000 the San Diego City Council amended their elected officers' pension plan to increase their pension benefits retroactively by awarding themselves 3.5% per year for all years they served.<sup>33</sup> The San Diego City Attorney was given the same 3.5% per year retroactive benefit on 8 October 2001.<sup>34</sup>

San Diego City Mayor Susan Golding, City Council members Harry Mathis, Byron Wear, Chris Kehoe, Valerie Stallings, Judy McCarty, and Juan Vargas all participated in granting themselves these benefits by voting to adopt the related ordinance.<sup>35</sup>

Also participating in the decision to grant the elected officials retroactive benefits were Deputy City Attorney Teresa C. McAteer and Labor Relations Director Daniel E. Kelley.<sup>36</sup>

The cost of the increased retroactive benefits for elected officials was represented to the City Council as approximately \$53,000 annually.<sup>37</sup> The Labor Relations Director described and attempted to justify the increased pension benefits for elected officials:

**Background**

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<sup>33</sup> San Diego City Council Ordinance No. 018847. 12 September 2000 San Diego City Council Minutes p. 14. (Exhibit 30)

<sup>34</sup> 8 October 2001 San Diego City Council Meeting Minutes. (Exhibit 31)

<sup>35</sup> *See footnote 33.*

<sup>36</sup> *See Footnote 33.*

<sup>37</sup> 7 August 2000 San Diego City Council Minutes p. 9 for ITEM 52. (Exhibit 32)

During the analysis and review of the Corbett settlement it became apparent that the Legislative Officers Retirement Program had not kept pace with the benefit adjustments provided as a result of the meet and confer process for Safety and General Members over the past decade.

## **Proposal**

The adjustments contained in the attached ordinance provide for a reduction in the age for eligibility from the current age of 60 with four years of service, to age 55 with four years of service. Members with eight years of service would be eligible to retire before age 55 with a benefit reduction of 2% for each year under the age of 55. The current calculation factor of 5% of the first \$500 of final monthly compensation, and 3% of the excess compensation above \$500, would be adjusted to 3.5% of all final compensation.

### **City Manager's Recommendation:**

Approve the amendment to Sections 24.0545 and 24.0546 of the San Diego Municipal Code pertaining to the Legislative Officers Retirement Program. Approximate cost is \$53,000 annually and is covered by the SDCERS employers' contribution rate.

In addition to the retroactive increase in pension benefits elected officials also purchased service credits for years beyond the number permitted under term limits. Council members are restricted to serving no more than two consecutive four-years terms. 38 Council members were permitted to serve eight years and to purchase up to five additional years of service credits for a total of 13 years.

San Diego City Mayor Susan Golding served a total of eight years as Mayor. She retired in the year 2000. She purchased five years of service credits at a price below the correct rate. Her annual pension includes the retroactive benefits she voted to adopt on 12 September 2000.

San Diego City Council Member Valerie Stallings resigned on January 29, 2001. Her annual pension includes retroactive benefits.

San Diego City Council Member Chris Kehoe retired in the year 2000. She purchased five years of service credits at a price below the correct rate. Her annual pension includes retroactive benefits.

San Diego City Council Member Barbra Warden resigned from office in 2001. She purchased .296 years of service credits at a price below the correct rate. Her annual pension includes retroactive benefits.

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<sup>38</sup> San Diego City Charter § 12(f). 4 February 2008 letter from San Diego City Attorney Michael J. Aguirre to Christopher W. Waddell Esq. (Exhibit 33).

San Diego City Council Member Harry Mathis retired in 2001. He purchased five years of service credits at a price below the corrective rate. His annual pension includes retroactive benefits.

San Diego City Council Member Byron Wear retired in 2002. His annual pension includes retroactive benefits.

San Diego City Council Member Judy McCarty retired in 2000. She purchased five years of service credits at a price below the correct rate. Her annual pension includes retroactive benefits.

San Diego City Council Member Juan Vargas retired on 2000. He purchased five years of service credits at a price below the correct rate. His annual pension includes retroactive benefits.

San Diego City Attorney Casey Gwinn retired on 7 December 2004. He purchased five years of service credits at a price below the actual rate. His annual pension violates IRS 415 Limits by \$46,812 annually.

## **VI. CITY OFFICIALS BENEFITED FROM THE ILLEGAL PENSION BENEFITS MP II**

In 2002 San Diego City officials again indebted the City to pay increased pension benefits without a vote of the public in violation of debt law requiring a public vote and the prohibited financial interest law.

The discussions related to the 2002 plan to increase benefits without funding began before the City Council by 18 March 2002. Labor Relations Manager Daniel E. Kelley sent a memorandum to the City Council for the Closed Session for 18 March 2002 that contained slides explaining the plan to increase the general member employee per year percentage to 2.25%. The slides also showed that the funding status was reaching the point that would require the City Council to make a significant contribution to the pension fund.<sup>39</sup>

The City Council was directly involved in negotiating the plan to increase benefits and decrease contributions with the pension board through Human Resource Director Cathy Lexin

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<sup>39</sup> 18 March 2002 Closed Session Report with attached 15 March 2002 memorandum from Daniel E. Kelley to the Mayor and City Council. 12 April 2002 Closed Session Memorandum from Human Resources Director Cathy Lexin and Deputy City Attorney Elmer Heap. 29 April 2002 Closed Session Report (with power point slides). (Exhibit 34).

and Deputy City Manager Bruce Herring.<sup>40</sup> Mayor Murphy and Council members Scott Peters, Jim Madaffer, Brian Maienschien, Ralph Inzunza and Toni Atkins voted in favor of the proposal to increase benefits and decrease contributions.<sup>41</sup>

Deputy City Attorney Elmer Heap also participated as did Executive Assistant City Attorney Leslie Devaney, and Assistant City Attorney Les Girard.<sup>42</sup>

The wrongfulness of the proposal to increase benefits and decrease contributions was brought to the attention of the City Council by SDCERS board member Diann Shipione.<sup>43</sup> The unlawful nature of the proposal to increase benefits in exchange for decreasing contributions was also brought to the attention of the pension board.<sup>44</sup>

In addition, a special benefit was given to two union presidents who were instrumental in gaining passage of the proposal to increase benefits in exchange for decreasing contributions by the pension board.<sup>45</sup>

San Diego City Mayor Dick Murphy received the benefit of the increased annual percentage at which retirement benefit accrued directly and in connection with his purchase of service credits.

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<sup>40</sup> 14 June 2002 memorandum from Human Resources Director Cathy Lexin, Head Deputy City Attorney Elmer Heap. 9 July 2002 Closed Session Report (signed Assistant City Attorney Les Girard). 11 July 2002 SDCERS Minutes pp. 1, 34, 35 and 38. 21 October 2002 San Diego City Council Minutes pp. 1-2 and 9-11. 18 November 2002 San Diego City Council Minutes pp. 1-3, 5-6, 8-9 and 39. (Exhibit 35).

<sup>41</sup> *See at Id.*

<sup>42</sup> *See at Id.*

<sup>43</sup> 18 November 2002 letter from Diann Shipione to Honorable Dick Murphy and Members of the City Council. (Exhibit 36)

<sup>44</sup> 5 March 2002 letter from Michael Leone, attorney at Seltzer Caplan McMahon & Vitek, to Sheila Leone, attorney at SDCES. 29 October 2004 Memorandum from Lawrence B. Grissom, SDCERS Retirement Administrator, to Lamont Ewell, San Diego City Manager. (Exhibit 37)

<sup>45</sup> 13 June 2002 memorandum from Human Resource Director Cathy Lexin and Head Deputy City Attorney Elmer Heap. 30 April 2002 Closed Session Report (signed by Assistant City Attorney Leslie Girard). 6 May 2002 San Diego City Council Meet and Confer Power Point Presentation. 6 May 2002 San Diego City Council Closed Session Report (signed by Executive Assistant City Attorney Leslie Devaney). (Exhibit 38) Also See United States Grand Jury Indictment in US v. Saathoff ; *see Footnote 11.*

Council member Jim Madaffer stands to gain from the unlawful pension scheme. He is credited with retroactive benefits. He purchased five years of service credits at a price below the correct rate.

Council member Brian Maienschein stands to gain from the unlawful pension scheme. He is credited with retroactive benefits. He purchased five years of service credits at a price below the correct rate.

Council member Ralph Inzunza purchased five years of service credits at a price below the actual rate. He received retroactive benefits.

Council Member Toni Atkins stands to gain from the unlawful pension scheme. She purchased five years of service credits at a price below the actual rate. She received retroactive pension credits directly and in connection with her purchase of pension credits.

City Labor Relations Manager Daniel E. Kelley stands to gain from the unlawful pension scheme. He purchased five years of service credits. He received retroactive pension credits directly and indirectly through his purchase of service credits.

Executive Assistant City Attorney Leslie Devaney stands to gain from the unlawful pension scheme. She received retroactive pension credits directly and in connection with her purchase of pension credits.

City Human Resources Director and SDCERS Board member Cathy Lexin purchased five years of service credits at a price below the actual rate. She benefited from the retroactive pension credits directly and through her purchase of pension credits.

Head Deputy City Attorney Elmer Heap purchased stands to benefit from the unlawful pension scheme. He purchased three years of service credits at a price below the actual rate. He benefited from the retroactive pension credits directly and through her purchase of pension credits.

SDCERS Legal Counsel Lori Chapin purchased five years of service credits at a price below the actual rate. She benefited from the retroactive pension credits directly and through her purchase of pension credits.

Deputy City Manager Lamont Ewell stands to benefit from the unlawful pension scheme. He purchased five years of service credits at a price below the actual rate. He benefited from the retroactive pension credits directly and through her purchase of pension credits.

**VII.**  
**PENSION DEBT SCHEME GREW TO BECOME A FRAUD ON**  
**INVESTORS AND THE PEOPLE OF SAN DIEGO**

The pension unlawful debt scheme grew into a securities fraud. The SEC found that certain City officials acted intentionally to defraud the City's bond purchasers by concealing and misrepresenting the pension debt. Former City Auditor Ed Ryan, Pat Frazier former Deputy City Manager for finance, and City Manager Michael Uberuaga played key roles in the City's securities fraud arising out of the pension debt scheme.

SDCERS Board Member and City Treasurer Mary Vattimo stands to gain from the unlawful pension scheme. She purchased 1.83 years of service credits at a price below the correct rate. Her annual pension will include retroactive benefits.

City Manager Michael Uberuaga purchased five years of service credits at a price below the correct rate. His annual pension includes retroactive benefits.

Specifically, the SEC charged:

This matter involves the City of San Diego's violations of the antifraud provisions of the federal securities laws in connection with the offer and sale of over \$260 million in municipal bonds in 2002 and 2003. At the time of these offerings, City officials knew that the City faced severe difficulty funding its future pension and health care obligations unless new revenues were obtained, pension and health care benefits were reduced, or City services were cut. The City's looming financial crisis resulted from (1) the City's intentional under-funding of its pension plan since fiscal year 1997; (2) the City's granting of additional retroactive pension benefits since fiscal year 1980; (3) the City's use of the pension fund's assets to pay for the additional pension and retiree health care benefits since fiscal year 1980; and (4) the pension plan's less than anticipated earnings on its investments in fiscal years 2001 through 2003.

Despite the magnitude of the problems the City faced in funding its future pension and retiree health care obligations, the City conducted five separate municipal bond offerings, raising more than \$260 million, without disclosing these problems to the investing public. In each of these offerings, the City prepared disclosure documents that are used with municipal securities offerings—that is, preliminary official statements and official statements—and made presentations to rating agencies.<sup>2</sup> In addition, in 2003 it prepared and filed information pursuant to continuing disclosure agreements under Exchange Act Rule 15c2-12 with respect to \$2.29 billion in outstanding City bonds and notes.<sup>46</sup>

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<sup>46</sup> SEC Cease and Desist Order. (Exhibit 39)

First, with respect to the pension issues, the City failed in the Disclosures to reveal several material facts, including that (1) the City was intentionally under-funding its pension obligations so that it could increase pension benefits but push off the costs associated with those increases into the future; (2) because of the City's under-funding of its pension plan, its net pension obligation was expected to continue to grow at an increasing rate, reaching from \$320 million to \$446 million by the end of fiscal year 2009; (3) the City's unfunded liability was expected to continue to grow at a substantial rate, reaching approximately \$2 billion by fiscal year 2009; (4) this growth in the City's unfunded liability resulted from the City's intentional under-funding of its pension plan, the City's granting of new retroactive pension benefits, the City's use of pension plan earnings to pay additional benefits, and the pension plan's less than anticipated investment return; (5) the City's annual pension contribution was expected to more than quadruple by fiscal year 2009; and (6) the City would have difficulty funding its future annual pension contributions unless it obtained new revenues, reduced pension benefits, or reduced City services. Moreover, the City falsely disclosed in Appendix B to its preliminary official statements and its official statements that its net pension obligation was funded in a reserve.<sup>47</sup>

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The City, through certain of its officials, knew that its Disclosures were misleading. The Mayor and Council were responsible for approving the issuance of the bonds and notes, including issuance of the preliminary official statements and official statements. The Mayor and Council delegated final approval of the official statements to the City Manager. The City Manager's office was responsible for the preparation of the preliminary official statements and the official statements, including appendix A. The City Auditor's office was responsible for the preparation of appendix B to the preliminary official statements and official statements. Through their designees on the CERS Board, among other things, both the City Manager's and the City Auditor's offices had knowledge about the City's use of CERS's surplus earnings, Manager's Proposals 1 and 2, CERS's actuary reports for fiscal years 2001 and 2002, and CERS's response to the Blue Ribbon Committee Report. Also, several representatives of the City Manager's office, City Attorney's office, and Auditor and Comptroller's office attended relevant closed session meetings of the Council where Manager's Proposals 1 and 2 and the *Corbett* and *Gleason* litigations were discussed. Moreover, the Blue Ribbon Committee Report and CERS's response to the Blue

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*See at Id.*

Ribbon Committee Report were both presented to a committee of the Council at which officials from the City Manager's and Auditor and Comptroller's office were present. Finally, the offices of the City Manager and the City Auditor were responsible for the City's study of its pension obligations that occurred in early 2003. Through their participation and involvement in the above-referenced matters, certain city officials knew or were reckless in not knowing that the Disclosures were false and misleading.<sup>48</sup>

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The City, through its officials, acted with scienter.<sup>19</sup> City officials who participated in drafting the misleading disclosure were well aware of the City's pension and retiree health care issues and the magnitude of the City's future liabilities. Moreover, even though the City officials knew that the City's pension issues were of concern to the rating agencies, they failed to disclose material information regarding the City's pension and retiree health care issues. In light of the City's officials' detailed knowledge of the magnitude of the City's pension and retiree health care liabilities and of the rating agencies' interest in those liabilities, the City officials acted recklessly in failing to disclose material information regarding those liabilities.<sup>49</sup>

The SEC also brought a separate complaint against five City officials for securities fraud all of whom were key players in the pension debt scheme. The SEC charged Michael T. Uberuaga, the former City Manager; Edward P. Ryan, the former City Auditor and Comptroller; Patricia Frazier, the former Deputy City Manager for Finance; Teresa A. Webster, the former Assistant City Auditor and Comptroller; and Mary E. Vattimo, the former City Treasurer.

Specifically the SEC complaint charged that these five former City officials:

4. During 2002 and 2003, the five Defendants knew, among other things, that the City faced severe difficulty funding its future pension and retiree health care obligations unless new revenues were obtained, pension and health care benefits were reduced, or City services were cut. They also knew that the City's looming financial crisis resulted from (1) the City's intentional under-funding of its pension plan since fiscal year 1997; (2) the City's granting of additional retroactive pension benefits since fiscal year 1980; and (3) the City's use of the

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<sup>48</sup> See at *Id.*

<sup>49</sup> See at *Id.*

pension fund's assets to pay for the additional pension and retiree health care benefits since fiscal year 1980.

5. Nevertheless, Uberuaga, Ryan, Frazier, Webster, and Vattimo acted recklessly in failing to disclose these and other material facts to investors and to rating agencies.<sup>50</sup>

The United States Grand Jury has also brought criminal charges against some of those who participated in the unlawful pension scheme. The Grand Jury Indictment charges:

Count 1  
18 U.S.C. § 371  
The Conspiracy

26. Beginning in or before January 2001, and continuing up to and including January 6, 2006, within the Southern District of California, and else where, defendants Saathoff, Lexin, Webster, Grissom, and Chapin did knowingly conspire with each other and others known and unknown to the grand jury to commit offenses against the United States, that is, mail and wire fraud, by conspiring and agreeing to devise a material scheme and artifice to defraud, including to deprive the SDCERS Board Trustees, members of SDCERS, and the citizens of the City of San Diego of their intangible right of honest services of their public officials to be performed free from corruption, fraud, undue influence, conflict of interest, and deceit and, with the intent to defraud, to obtain money and property by means of materially false and fraudulent pretenses, representations, and promises, and the intentional concealment, failure to disclose, and omission of material facts ...<sup>51</sup>

**VII**  
**City Attorney's Efforts to Set Aside the Unlawful Pension Debt**

On 27 January 2005, SDCERS filed a civil complaint against the San Diego City Attorney to recover boxes of documents under subpoena by the Grand Jury and SEC which the City Attorney obtained with the intent of producing under the subject subpoenas.<sup>52</sup>

In addition SDCERS sought and received a court order allowing SDCERS to retain counsel separate from the City Attorney despite the Charter and Municipal Code provisions

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<sup>50</sup> See Footnote 12.

<sup>51</sup> See Footnote 11.

<sup>52</sup> A full, true, and correct copy of the SDCERS complaint. (Exhibit 40).

designating the City Attorney as the city official who appoints counsel for the pension board.<sup>53</sup> The court also denied SDCERS request that the City Attorney from expressing his point of view that the City Attorney under the City Charter was the attorney for SDCERS.<sup>54</sup>

SDCERS filed a separate complaint against the City of San Diego requesting an order permitting SDCERS to continue to pay pension benefits the City Attorney claimed were illegal.<sup>55</sup> SDCERS summary judgment motion was granted in favor of SDCERS on 16 October 2006.

On 8 July 2005 the City filed a cross-complaint to SDCERS' complaint filed on 27 January 2005 seeking to set aside the pension illegal benefits. The operative version of this complaint became the basis of a trial on procedural and not the merits of the City's case. The trial court ruled against the City on procedural grounds in January 2007.

In April 2008 the City appealed the trial judgment against the City.<sup>56</sup> SDCERS motion to dismiss the appeal was granted in November 2008 and the City filed for reconsideration a few days following the granting of the dismissal motion by the appellate court. The City's motion for reconsideration is pending with the state court.

The City filed another legal action to challenge the decision by SDCERS to pass on debt to the City for service credits sold to city employees below the correct prices.<sup>57</sup> This ruling will save San Diego taxpayers over \$40 million. It represented the first time the City's case was considered on the merits.

## **VIII LEGAL REFORMS TO THE PENSION PLAN URGED BY CITY ATTORNEY GO UNHEEDED**

The City Attorney has repeatedly urged legal reforms to the pension plan.<sup>58</sup> Those reforms have not been adopted. The pension plan management remains in the hands of those who stand to receive the unlawful pension benefits and their political allies.<sup>59</sup>

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<sup>53</sup> See San Diego City Charter § 40; Municipal Code § 24.0911. (Exhibit 41). The Court ruled in favor of SDCERS to the extent that SDCERS was entitled to separate representation in the pending litigation. The issue about whether SDCERS is entitled to separate counsel in other matters remains an open legal question.

<sup>54</sup> 23 August 2005 San Diego City Attorney News Release. (Exhibit 42).

<sup>55</sup> *See footnote 52*

<sup>56</sup> Full, true, and correct copies of the City's briefs. (Exhibit 43)

<sup>57</sup> A full, true, and correct copy of the ruling. (Exhibit 44)

<sup>58</sup> November 2007 City Attorney Memorandum Request for Action by City Council on Purchase Service Credits. (Exhibit 45)

The City Attorney urged that the illegal pension debt be set aside, the pension migrate to less risky investments, and that steps be taken to bring the growth rate of liabilities and assets into balance. This was rejected, the pension moved heavily into mid and small cap stocks at a substantial cost to the fund.<sup>60</sup>

The pension as of 31 October 2008 had about \$6.5 billion in liabilities and \$3.78 billion assets leaving a deficit of \$2.7 billion.<sup>61</sup> Had the City Attorney's plan to rid the pension system of the unlawful pension debt and move into less risky investments been adopted the pension would be almost fully funded. Instead, the pension is now \$2.7 billion in the red.

The City was found by the SEC to have concealed the pension debt to the point of commitment securities fraud. One plan under consideration by the SDCERS pension board would push off the pension debt to the next generation. The unfunded liability of \$2.7 billion would be amortized over 15 years.

Costs associated with needed changes to the pension fund assumptions would be amortized over 30 years. These amortizations are in addition to the 20 year amortization used by SDCERS for its existing unfunded liability. The voter approved amortization period of 15 years has not been followed.<sup>62</sup>

## IX CONCLUSION

The City's pension plan funding has had and will continue to have a substantial and material impact on the San Diego City government's ability to provide essential services to the people of San Diego.<sup>63</sup> The pension managers and other City officials attempted to enrich themselves by creating hundreds of millions of dollars of pension debt.<sup>64</sup> The debt was concealed and manner in which it was formed went undisclosed and formed the basis for federal prosecutions by the SEC and US Attorney.<sup>65</sup>

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<sup>59</sup> See Interim Report 27 Fiduciary Law And The San Diego Pension Crisis pp. 16-25. (Exhibit 46)

<sup>60</sup> 28 June 2008 Executive Summary of the Investment Manager Structure Analysis. (Exhibit 47).

<sup>61</sup> Hall, Mathew T, "Pension Shortfall has grown to \$2.7 billion, analysis says," *San Diego Union-Tribune*, 13 November 2008. (Exhibit 48). *Also see footnote 10.*

<sup>62</sup> See Proposition G. (Exhibit 49).

<sup>63</sup> See San Diego City Attorney Interim Report No. 24.

<sup>64</sup> See San Diego City Attorney Interim Reports 3, 6, and 19.

<sup>65</sup> See US Grand Jury Indictment and SEC Cease and Desist Order at Footnotes 11 and 12.

City officials chose not to make reforms to the pension plan and not to set aside the illegal pension benefits. Instead, pension managers chose a risky investment policy that resulted in substantial losses to the pension system. The current course of conduct has resulted in the need to consider whether reorganization of the City under the protection of federal insolvency laws is warranted.

A handwritten signature in black ink, appearing to read "Michael J. Aguirre". The signature is written in a cursive, flowing style.

Michael J. Aguirre  
San Diego City Attorney