

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
STAFF REPORT
LEGAL SERVICES DIVISION

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DATE: October 11, 2005

TO: The Board of Administration, via Lawrence B. Grissom, Retirement Administrator

FROM: Loraine Chapin, General Counsel

SUBJECT: October Legal Services Division Report

I. BOARD MEMBER APPOINTMENT

On October 10, 2005, the City Council appointed a new member to the SDCERS Board. George A. Murray was approved by a vote of 5-1 with Council Member Frye voting against his nomination. Mr. Murray retired in 2001 as a senior director of Prudential Securities. He also worked for Merrill Lynch, Shearson Lehman Brothers and Dominick & Dominick Inc. With Mr. Murray's appointment, the SDCERS Board has only one remaining vacancy.

II. RECENT STATE ACTIVITY

1. State Legislation: SB 1007

On September 29, 2005, Governor Schwarzenegger signed SB 1007 into law. As background, Senator Ducheny introduced SB 1007 on February 22, 2005 to amend state law to permit the Port District, a participating employer in SDCERS, to establish its own independent retirement and disability system for its employees. Before this bill, the only other option available to the Port was participation in CalPERS.

Specifically, SB 1007 authorizes the Port District to contract with any other employee retirement and disability system, or to establish an independent employee retirement and disability system pursuant to certain provisions authorizing the legislative body of a local agency to establish a pension trust funded by individual life insurance contracts, individual annuities, group policies of life insurance, or group annuities, or any combination of those. The bill takes effect immediately as an urgency statute.

We have also received a request from CalPERS staff for copies of the complaints pending against SDCERS and the funded ratios for all participating employers. We were informed this is background information needed to assess any proposed application to participate in CalPERS. We are not aware of any request by either the Port district or the Airport Authority to join CalPERS at this time. Under the existing agreement with SDCERS, the Port District must provide one year notice before canceling its agreement.

2. Attorney General Opinion No. 04-710

On October 4, 2005, the Attorney General issued an opinion addressing whether a city charter may require that the board of retirement of a city's employee pension system place certain costs on specified amortization schedules. After review and analysis of the home rule provisions of the State Constitution, the Attorney General concluded that "the charter may not so provide because to do so would conflict with another provision of the Constitution." (Emphasis added.) A copy of this opinion is attached.

This is a significant issue for further discussion because Proposition G adopted by the voters in November, 2004 amended San Diego City Charter section 143 to place the costs associated with past service liability and net accumulated actuarial losses on specified amortization schedules. Under the rationale of the Attorney General's opinion, a strong argument can be made that portions of the amended Charter section 143 may be unenforceable. Lacking the time to thoroughly analyze this opinion for inclusion in this month, we will issue a separate report in the very near future.

III. FEDERAL DEVELOPMENTS OF NOTE

In the spring of 2005, the staff members of the Joint Committee on Taxation (JCT) presented options for changing the tax treatment of pensions and other provisions of the Internal Revenue Code. Their publication, *Options to Improve Tax compliance and Reform Tax Expenditures*, contains five options that directly affect state and local government retirement plans. They are: 1) Repeal pick-up rules for employee contributions to state and local government retirement plans; 2) provide consistent FICA treatment of salary reduction amounts; 3) extend Medicare payroll tax to all state and local government employees; 4) provide greater conformity for Section 403(b) and Section 401(k) Plans; and 5) extend early withdrawal tax to eligible Deferred Compensation Plans of state and local governments.

The JCT characterizes this publication as a means to put forward ways for improving tax compliance and reforming tax expenditures. According to the JCT, the options would curtail tax shelters, closed unintended loopholes, and address other areas of non compliance in the law. In addition, the options raise revenue. Importantly, the options have NOT received the prior approval of key congressional leaders. This was by design. The option with the greatest potential effect on plan design for state and local government plans is the proposed repeal of employer pick-up.

Since SDCERS contains an employer pick-up as part of its plan design we will continue to monitor this issue.

IV. ADMINISTRATIVE DISABILITY HEARINGS (Unless otherwise noted, Sheila Jacobs, Esq. represents the Board in administrative hearings.)

Maria Estrella: The Honorable Raymond Zvetina's (Ret.) (JAMS) has recommended that Ms. Estrella's application be denied on the grounds her disabling back injury was not the result of her job. Ms. Estrella requested for additional time to file her objections, which was granted. Her objections are due October 3. Once the objection process is completed, the matter will appear on the Board's agenda for final decision.

Heleodoro Lopez: Administrative Law Judge Alan Alvord heard Mr. Lopez' application on August 30. His decision is pending.

Sherry Mallard: On September 21, Judge Robert O'Neill (ADR) heard Ms. Mallard's request to be found eligible to apply for industrial disability retirement. The Board contends Ms. Mallard did not timely file an application within 3 years of ceasing membership in SDCERS. Based on the evidence presented by Ms. Mallard, Judge O'Neill indicated he will recommend that the Board find Ms. Mallard is not eligible to apply. A written recommendation is pending and will be presented to the Board in November.

Herman McFeely: Judge Carolyn Magnuson (OAH) heard Mr. McFeely's application for industrial disability retirement on June 3. A decision is pending.

Louis Rodriguez: Judge Greer Knopf (OAH) heard Mr. Rodriguez' claim on September 28th. A second morning of hearing has been calendared for December 7 for the purpose of allowing Mr. Rodriguez' counsel to cross-examine a police department employee on facts set forth in a sworn declaration by the employee. Closing arguments will be submitted in writing after December 7.

The following hearings have been calendared: Max Camberos, October 5 (OAH); Fernando Mercado, October 31 (JAMS); Kenneth Hawkins, November 14 (JAMS); Jon Kern, November 16 (OAH); Ralph Basquez, December 6 (JAMS); and Louis Rodriguez (2nd day), December 7, OAH.

The following pre-hearings have been calendared: Philip Thren (October 10); Robert O'Donnell (October 11); John Garcia (October 28); Theresa Rice (November 7); and Windy Jones (November 14).

The following matters have completed the pre-hearing process, but have not been calendared for hearing: Sharon Bergan, Alphonso Dobyne; Samuel Campbell, Constantino Delimitros, Alan Fragoso, Emilio Romero, Francisco Torres, Bridget Tubbs, and Raul Padilla.

The following applicants have been referred for hearing, but no dates have been set: Robert Neal, Maria Collin, Joe Rainbolt, Harvey Kitchel, Donovan Knapp, Linda LaCrusa, Scott Naliboff, Brad Ruff, Debra Mattie, Michael Wahl, James Clem, Carlos Guzman, Michael Williams, Harold Cox, and Felix Zavala.

V. LITIGATION

Superior Court - Disability Cases

Sergio Alcala v. San Diego City Employees' Retirement System Board of Retirement, San Diego Superior Court Case number GIC847606. SDCERS Answer to Alcala's Petition for Writ of Mandate was filed on June 30, 2005. The matter has been transferred from Judge C. Wickersham to Judge William Pate. The Court has not yet set a briefing schedule. Matt Davis, Esq. is representing Mr. Alcala.

Superior Court – Miscellaneous

Michael Abramsky, et al. v. Alstom S.A. et al.: 03-CV-6595 (VM) United States District Court, Southern District of New York (Manhattan): No change since last month. SDCERS has been appointed co-lead plaintiff, along with 3 other public retirement funds in this securities fraud class action lawsuit against the French corporation, Alstom and a number of its affiliates. Plaintiffs' First-Amended Complaint was filed April 30, 2004. Several motions by the defendants to dismiss the complaint are pending. Berstein, Litowitz, Berger and Grossman represents the Board.

People of the State of California v. Lawrence Grissom, et al., San Diego Superior Court case number GIC850246. On July 6, 2005, the City Attorney brought this action against the administrator, general counsel, and several former trustees alleging a violation of the State's Political Reform Act of 1974. The case was dismissed by the Honorable Charles Wickersham on September 30. Seltzer, Caplan, McMahon & Vitek represented Mr. Grissom and Ms. Chapin. The City Attorney may appeal the decision to the Appellate Court.

SDCERS v. City of San Diego & City Attorney, Michael Aguirre, On January 27, 2005, the Board filed a lawsuit against the City of San Diego and its City Attorney, Michael Aguirre seeking judicial declaration that SDCERS is entitled to retain its own legal counsel and demanding return of SDCERS' privileged documents seized from a SDCERS Board member's City office. A copy of the complaint is available on the SDCERS website under Publications, Recent Events at www.sdcers.org. The case was assigned to the Honorable Jeffrey Barton. Seltzer Caplan McMahon & Vitek (SCMV) represents SDCERS.

In July, 2005, the City Attorney filed a cross-complaint alleging numerous causes of action alleging such things as fraud, misrepresentation, illegal benefits and receivership. SCMV filed a demurrer. On August 23, 2005, Judge Barton ruled on SDCERS' demurrer and

held SDCERS is an independent entity entitled to retain its own counsel. The City Attorney was not granted leave to amend his cross-complaint on this issue. With respect to other issues raised by the City Attorney, the court granted leave to amend the stated pleading deficiencies. A third amended cross-complaint has been filed. SCMV intends to demur to this complaint as well. No date has been set. SCMV is currently working on a Motion to Consolidate related cases. There is a hearing on this motion at 3:00 PM on October 27, 2005 in Department 69.

SDCERS v. City of San Diego, San Diego Superior Court case number GIC851286. On July 22, 2005, the Board voted unanimously (8-0) to file an action for declaratory relief seeking a judicial determination of the legality of payment of contested retirement benefits to its members. The lawsuit was filed on July 26, 2005. Since that time, various employee unions have intervened in the case and will support SDCERS' position in the lawsuit. The case was assigned to the Honorable J. Bloom. Seltzer, Caplan, McMahon & Vitek is representing SDCERS. The next hearing is at 11:00 on December 9, 2005 in Department 70 to hear the City's Motion to Strike the Complaints of the Interveners.

SDCERS et. al. v. Delphi Corporation, Case No. 05-CV-2656(NRB): SDCERS is seeking co-lead plaintiff status in this securities class action matter. Bernstein, Litowitz, Berger and Grossman represents the Board.

San Diego Police Officers' Association v. Michael Aguirre, et al., United States District Court case number 05CV1581. On August 9, 2005, the San Diego Police Officers' Association (POA) filed a complaint in federal court for Damages, Declaratory and Injunctive Relief against the City Attorney, City of San Diego, Retirement System, Retirement Administrator, past and present members of the City Council, certain former SDCERS Board Members, the former City Auditor and the past and present City Manager. By Stipulation, the administrator has been dismissed from this action. Seltzer Caplan McMahon Vitek will handle this matter on behalf of the Retirement System and its Retirement Administrator. The next hearing is a Motion for Preliminary Injunction and/or Motion to Dismiss to be heard at 9:30 AM on November 1, 2005 in Courtroom 13, Federal Court, the Honorable Marilyn Huff presiding.

Court of Appeal

The Board is not a party to any case pending before the Court of Appeal.

Other Cases of Interest:

City of San Diego v. Callan Associates, Inc., Gabriel Roeder Smith & company, San Diego Superior Court Case number GIC852419. On August 16, 2005, the City of San Diego filed a Complaint for Damages against SDCERS investment consultant and actuary for professional negligence, intentional fraud-affirmative misrepresentation and intentional

fraud-concealment. The case has been assigned to the Honorable Kevin A. Enright. SDCERS is not a party to this case.

City of San Diego v. Richard Murphy, Michael Zucchet and Ralph Inzunza, San Diego Superior Court case number GIC854373. On September 23, 2005, the City attorney filed a Complaint for Declaratory Relief, violations of Government Code section 1090 and the Political Reform Act (Government Code sections 87100, et. seq., against the above referenced individuals. The case has been assigned to the Honorable Richard Y. Montes. According to the first paragraph of the Complaint, he brought this action "on behalf of the citizens of San Diego and all beneficiaries of the San Diego Employees' Retirement System. The primary thrust of this complaint is the City Attorney's contention that elected officers need 10 years of creditable service to vest. SDCERS is not a party to this suit.

People of the State of California v. Cathy Lexin, et. al., San Diego Superior Court case number CD 190930. The District Attorney filed felony conflict of interest charges against five former and one current SDCERS Board Member(s) alleging a violation of California Government Code section 1090. The case was assigned to the honorable Frederick Link. SDCERS is not a party to this suit. A Preliminary Hearing has been set for October 26, 2005. We have been informed this hearing may be continued until the latter part of January, 2006.

VI. SAN DIEGO MUNICIPAL CODE AMENDMENTS

There is no change. The Board approved a Technical Corrections Ordinance in August 2004, and directed legal staff to forward it to the City Manager and City Attorney, and work with the appropriate City personnel to have the ordinance placed on the City Council docket for adoption. The fate of this ordinance remains uncertain. It is still with the City Attorney's Office.

VII. MINIMUM DISTRIBUTION RULES

Staff prepared informational packets to send to DROP participants regarding the amendments made to the DROP distribution Board Rules. These amendments were recommended by Staff and approved by the Board to bring SDCERS into compliance with the Final Regulations issued under Internal Revenue Code section 401(a)(9). The Final Regulations were issued on June 14, 2004. They take effect January 1, 2006.

VIII. PURCHASE OF SERVICE CREDIT AND DEFERRED COMPENSATION

No change. We are seeking a Private Letter Ruling (PLR) to support the use of an affidavit certifying corresponding service with another employer as a means of allowing members to purchase service credit under SDMC § 24.1312 (5-year purchase) with 457 deferred compensation funds. Tax Counsel advised a slight delay after learning that the IRS would

be releasing a private letter (PLR) ruling very soon. Even though PLRs are only binding on those who requested them, they are relied upon to draft requests in a manner to be more favorably received by the IRS.

IX. PUBLIC RECORDS REQUESTS

In September, Legal staff received 10 public records requests. Staff responded to 4 requests. These requests were regarding former councilmember Mike Gotch's entry to SDCERS, age now and his age when he retired; annual salary used to figure out his pension; Dick Murphy, Ralph Inzunza and Michael Zuchett, eligibility for retirement, whether they entered the DROP program, purchase of service credits and monthly pension; documents provided by SDCERS to the Audit Committee and KPMG as a result of the Retirement Board's actions on August 30, 2005; all records from 1993 to the present relating to purchases of service credit. Roxanne is handling these public records requests with the assistance of Merlita Hilario, our legal assistant.

X. COMMUNITY PROPERTY

In September, legal staff handled 40 telephone calls, met with 11 members, and had 17 conferences with staff. Sixteen domestic relations orders, final judgments and marital settlement agreements were reviewed and acted upon. Nineteen member files were reviewed for legal issues. One production of documents was completed. Twenty-six letters and e-mails to members, outside counsel, and others were prepared, along with 4 community property packages, and 23 staff memos. Staff researched 12 court records, and conducted 7 public records searches at the request of operations staff. Roxanne handles community property issues, with the assistance of Sally Nadeau, our senior legal assistant.

XI. KROLL STATUS REPORT

Two weeks ago Kroll representatives appeared before the City Council and indicated there were documents they had not been able to obtain. Specifically, there was a reference to 400 documents missing and certain opinions listed on the privilege log but not within the data base. Seltzer Caplan McMahon Vitek (SCMV) met with Kroll representatives and resolved these issues. Subsequently, SCMV and Kroll discovered other technical problems with source data corruption or errors in the data conversion process impacting approximately 2,000 e-mails. IT staff at SCMV has been working with all affected parties for some time to identify and locate the affected e-mails and attachments. We have been informed that all of these e-mails have now been identified.

As a short term fix, SDCERS will print hard copies of the affected e-mails and attachments and produce them to Kroll and other investigating agencies. In the longer term, SDCERS is working with Kroll to fix the problems in the conversion process so that there will be an

error-free conversion of e-mails and attachments to the data base. Although there may be claims that this is further evidence of non cooperation, this is not the case. SCMV had identified this and was working on it before Kroll raised it with them. According to SCMV, it is purely a technical problem resulting from the type of software used to run both the City's and SDCERS' servers. SCMV continues to work with Kroll to resolve these issues and once resolved, all documents will be produced to Kroll and the investigative agencies who have been kept informed of SCMV's efforts on an ongoing basis.

XII. TAX DETERMINATION LETTER & VOLUNTARY CORRECTION PROGRAM

The Tax Determination Letter (TDL) and the Voluntary Correction Program (VCP) were filed July 12, 2005. Outside Tax Counsel (Ice Miller) is handling this matter for SDCERS. The operational review in conjunction with these applications is underway. Tax Counsel will be present at the September Operations Board meeting.

XIII. REQUEST FOR LEGAL SERVICES

No change. There is still a pending Request for Proposal for legal services. Staff expects to complete review of the responses and report to the Board at the November meeting.

XIV. ROLL BACK OF RETIREMENT BENEFITS

On October 10, 2005, the City Attorney and Council Member Frye held a joint press conference to announce a proposal to wipe out pension benefits alleged to be illegal. Under the proposal, the City Attorney would draft an Ordinance to rescind the benefits created by the City Council in 1996 and in 2002. It would then be up to Deputy Mayor Atkins to docket the matter for consideration of the full City Council. We are informed that in a later interview, Aguirre said that if the City Council approves the ordinance, he would not sue if for "insisting on keeping the illegal benefits."

Although it is not clear if such an ordinance would get the 5 votes needed to approve it, there are yet additional hurdles. San Diego City Charter section 143.1 provides that no ordinance affecting the retirement benefits of any employee under the System can become law unless it is approved by a vote of the Members of SDCERS. This is an absolute requirement. As a reminder, it is our view that only a court can make the determination regarding the legality of the contested benefits. SDCERS has filed an action for declaratory relief seeking this very determination. Until the court speaks otherwise, we will continue to administer the benefits as set forth in the SDCERS plan documents.

XV. INDEMNIFICATION OF SDCERS STAFF

Fiduciary Counsel has prepared a Board Resolution regarding the Indemnification and Defense of SDCERS employees. His report, recommendation, and proposed Board

Resolutions are in the October Board packet. Fiduciary Counsel has indicated he will address Indemnification and Defense of SDCERS Trustees in a future report.

XVI. SEC INVESTIGATION

On October 11, 2005, we received a copy of a letter dated October 10, 2005 from Thomas A. Zaccaro, an attorney with the firm of Akin Gump Strauss Hauer & Feld LLP to City Attorney Michael Aguirre. The letter was sent to Mr. Aguirre on behalf of Council Member Jim Madaffer to address their serious reservations about the City Attorney's participation in connection with his discussions with the staff of the SEC. The letter is provided because it gives a very succinct summary of the facts and involvement of City staff and others with the bond disclosures underlying the current investigations. A copy of the letter is attached to this report.

LEC:dm

- Attachments:
1. Opinion No. 04-710 dated 10/4/05 issued by the Attorney General
 2. Letter dated 10/10/05 from Thomas Zaccaro to Michael Aguirre