

TO: Files

CC: San Diego Audit Committee

FROM: Willkie Farr and Gallagher LLP

RE: Interview of Richard Vortmann on May 1, 2006

DATED: May 13, 2006

On Tuesday, May 1, 2006, Michael Schachter and Jesenia Ruiz de la Torre, in Willkie Farr & Gallagher LLP's capacity as counsel to the Audit Committee, interviewed Richard Vortmann. He was represented by counsel, John Mitchell. Also in attendance were Jennifer Arnini of Kroll Inc., Rahul Khona and Donielle Evans of KPMG. The interview took place in a conference room on the 3rd floor of the City Administration Building and lasted approximately six hours.

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

Warnings

Mr. Schachter began the interview by explaining the circumstances and purpose of the City of San Diego's (the "City") creation of the Audit Committee, noting that information obtained during the course of the interview would be used, if relevant, in the Audit Committee's eventual report. Mr. Schachter explained that Willkie does not represent Mr. Vortmann and, thus, statements made during the interview are not covered by the attorney-client privilege. Nonetheless, we would be treating the information obtained during the interview as confidential, covered by the work-product privilege during the investigation, but any such privilege would likely be lost with the release of the Audit Committee's report. Mr. Schachter asked that Mr. Vortmann keep the interview confidential. Mr. Schachter further explained that, if requested, we would provide information from the interview to the SEC, the U.S. Attorney's Office or the City's outside auditor, KPMG, so it is important that Mr. Vortmann be accurate and truthful. Mr. Schachter emphasized that Mr. Vortmann should seek clarification of any question at any time. Mr. Mitchell asked whether Mr. Vortmann would have the opportunity to review and correct the interview summary and was told that he could not since the memo was protected attorney work product.

Background

Mr. Schachter asked Mr. Vortmann where he is currently employed. Mr. Vortmann replied that he is currently the President of NASCO, a steel company that contracts to

build ships. Mr. Schachter then asked Mr. Vortmann to discuss what in his background led to his appointment to the Blue Ribbon Committee (the "BRC"). Mr. Vortmann stated that he had experience managing a private pension plan as the head of a company that had a defined benefit and contribution plan; Mr. Vortmann had also dealt with unions and retiree medical benefits. Mr. Vortmann explained that he was appointed to the BRC by Mayor Murphy because of his involvement in the Mayor's campaign (he was active in the Mayor's campaign and contributed approximately \$500) and as a result of an acquaintance advocating for his appointment. Mr. Vortmann's appointment to the BRC was his first experience working in public service. Mr. Vortmann's appointment to the BRC led to his appointment to the SDCERS Board, in part because Terri Webster (BRC Staff and Assistant Auditor) advocated for his appointment, stating that the Board "could use Mr. Vortmann's kind of thinking."

Goals of The Blue Ribbon Committee

After Mr. Vortmann reviewed the BRC's Minutes dated May 7, 2001, stating that the goal of the Committee was to consider the budget process (Exhibit 1), Mr. Schachter asked Mr. Vortmann if that was accurate. Mr. Vortmann recalled that he thought that the BRC's goal was to assess the fiscal health of the City. He could not recall who expressed this as the goal of the BRC, but he assumed he would have had that conversation at some point prior to accepting a position on the BRC.

Mr. Schachter asked Mr. Vortmann when it was decided that the BRC would consider the pension system. Mr. Vortmann stated that he could not recall. Mr. Vortmann again reviewed the May 7, 2001 BRC Minutes (Exhibit 1). This was the first meeting of the BRC and Mr. Schachter pointed out that pension issues were not discussed at that meeting. Mr. Vortmann stated that when the BRC was established it was not yet decided that pension issues would be a segment of the report. Early on during BRC meetings there was an effort to understand which issues needed to be explored. Mr. Vortmann reviewed the May 25, 2001 BRC Minutes (Exhibit 2) and Mr. Schachter noted that of the various issues Ed Ryan (BRC Staff and City Auditor and Comptroller) had discussed at that meeting, pension issues were not among them.

After Mr. Vortmann reviewed the June 15, 2001 BRC Minutes (Exhibit 3), Mr. Schachter noted that this was the first time in the BRC Minutes where the pension system appeared to be an issue that would be explored. Mr. Schachter asked Mr. Vortmann who had brought up the pension system as a topic that should be addressed in the report. Mr. Vortmann could not recall who. Mr. Vortmann assumed that either Webster or Ryan did because BRC members would not have done independent research to discover new issues that needed to be explored. Mr. Vortmann reviewed the July 13, 2001 BRC Minutes (Exhibit 4), which contain a list of assignments given to the BRC members; Mr. Vortmann is listed as the lead individual regarding unfunded pension liabilities. Mr. Schachter asked Mr. Vortmann why he was assigned this topic. Mr. Vortmann stated that he volunteered to author the pension section because he had some experience with pensions as described above.

Preparation of the Blue Ribbon Committee Report

Mr. Vortmann reviewed an email from Webster to Lawrence Grissom (SDCERS Administrator) dated July 23, 2001 (Exhibit 5). Mr. Schachter pointed out that there were some questions which Mr. Vortmann had authored attached to the email and asked Mr. Vortmann on

what information those questions were based. Mr. Vortmann could not recall how he gathered the information which formed the basis for those questions, except that he recalled having had a conversation with Grissom. Mr. Vortmann assumed that the basis for those questions would have come from that conversation, because no one else assisted him. Mr. Schachter asked Mr. Vortmann if he could recall the July 20, 2001 email referenced in his fourth question in the July 23, 2001 email (Exhibit 5). Mr. Vortmann could not, but regarding the fourth question, Mr. Vortmann recalled that when he asked “[a]re certain specific assumptions never met? If so which, or what is the magnitude of the shortfall,” he wanted to know the extent to which the system was unfunded.

Mr. Vortmann reviewed a draft of the BRC’s report that he authored entitled “Employee Retirement Benefits Liabilities,” dated July 23, 2001 (Exhibit 6). Mr. Schachter asked whether Mr. Vortmann had any conversations regarding the handwritten notes on the document. The handwritten notes read “govt and industry norm” and “result of lawsuit settlement.” Mr. Vortmann recalled that granting new benefits retroactivity was the public industry norm; he believes that he discussed this with Webster. Mr. Vortmann opined that it was probably the norm to grant retroactive benefits considering how unions fought for benefits. Mr. Schachter asked Mr. Vortmann what he thought the note regarding “the result of the lawsuit” was referring to. Mr. Vortmann replied that that may have been a reference to the *Corbett* litigation, but he could not recall having any understanding of *Corbett* at the time that he wrote this draft. Mr. Schachter asked Mr. Vortmann from whom he had obtained the information he included in the pension section of the BRC. Mr. Vortmann stated that he could not recall how he compiled this information and he did not keep any documentation of whom he spoke to, but he was pretty confident that he spoke to Grissom on at least one occasion and had discussions with Ryan and Webster. Mr. Vortmann recalled that the BRC’s report concluded that the City was not paying its bills currently for pension and medical benefits. He recalled that either Grissom or Webster informed him of the percentage of that shortfall, but he could not recall that percentage. Mr. Vortmann recalled that the cause of the SDCERS unfunded liability was being explored by the SDCERS actuary after he reviewed an email that he sent to Webster, dated March 18, 2002 (Exhibit 7). Mr. Vortmann also recalled that the BRC’s report concluded the funding ratio would decrease, but he could not recall what facts led him to that conclusion.

Mr. Vortmann reviewed an email that he sent to Webster, through Leilani Hughes (Mr. Vortmann’s assistant), dated July 31, 2001 (Exhibit 8). A list of questions, dated July 30, 2001, that Mr. Vortmann had addressed to the City Manager and an email sent by Webster to Mr. Vortmann responding to those questions were attached to the email. Mr. Schachter asked Mr. Vortmann what he meant when he wrote in this email “[a]s long as this is comprehended in long term budget planning, than there is no big issue.” Mr. Vortmann replied that he was referring to whether or not the City understood that they were not funding the liabilities that they were currently incurring. Mr. Vortmann stated that he believed that the City did not have this understanding. Mr. Schachter then asked Mr. Vortmann if he knew what Webster was trying to say in her response to Mr. Vortmann’s fourth question in his July 23, 2001 email. Webster’s response was essentially that GAAP and GASB did not require estimating or acknowledging healthcare liabilities. Mr. Vortmann recalled not understanding Webster’s response when he received it. Now, Mr. Vortmann thinks that she was discussing how there were numerous funds that could be “dipped into” to cover the costs of healthcare and so the City’s budget would not be impacted. Mr. Vortmann recalled that SDCERS excess earnings, as well as other funds, would

be used to pay for the cost of healthcare. Mr. Vortmann stated that healthcare costs had not been incurred by the City until recently. Mr. Schachter asked Mr. Vortmann what response he had received regarding his question as to the estimated present value of retiree medical benefit liabilities. Mr. Vortmann recalled that he was told that the estimated present value of retiree medical benefits was \$100 million, despite a handwritten note indicating that the present value was \$200 million in the exhibit. Mr. Vortmann recalled discussing the cost of healthcare benefits with the BRC, Webster, and Grissom. Mr. Vortmann noted that the \$100 million figure "came off the top of someone's head" and he thought that it was disingenuous. Mr. Vortmann went on to say that a "pay-as-you-go" system was not acceptable. Mr. Schachter asked why that was the case. Mr. Vortmann recalled that the problem was related to deferring the cost of healthcare and pension benefits and that this in conjunction with the growing number of retirees created a problem. Mr. Vortmann felt that this was an "obvious accounting flaw." Mr. Schachter asked Mr. Vortmann if he received a response to his question regarding the logic of the reserves. Mr. Vortmann stated that he was sure that question was answered, but he could not recall what he was told. Mr. Schachter asked if SDCERS reserves were considered assets of the pension fund. Mr. Vortmann stated that they were not, but that he could not recall who gave him that information or when he became aware of that. Mr. Schachter turned Mr. Vortmann's attention to a handwritten note contained in the July 31, 2001 email (Exhibit 8). That note read "comments per Larry in meeting with Dick 7/31/01." Mr. Vortmann did not recall that conversation.

Mr. Vortmann reviewed an email he received from Webster, dated August 2, 2001, that had a PowerPoint presentation attached (Exhibit 9). Mr. Schachter asked Mr. Vortmann what the presentation was used for. Mr. Vortmann replied that it may have been a presentation that he made to the BRC. Mr. Vortmann recalled that he made a presentation regarding the pension system to the BRC to see if they agreed with his conclusions, could suggest other ways to gather additional information, and to get comments. Mr. Schachter turned Mr. Vortmann's attention to the third paragraph of Webster's email, where she stated that she was not comfortable with the statement "has an arrangement with the actuary." Mr. Vortmann could not recall receiving this email, but he did not think that Webster was manipulating him. Mr. Vortmann thought that the language Webster suggested was more descriptive. Mr. Schachter asked Mr. Vortmann why he discussed San Diego County's benefits in his PowerPoint presentation. Mr. Vortmann replied that he had learned from either Webster or Ryan that the County was contemplating increasing benefits. Mr. Vortmann thought that if the County granted those benefits, then there would be pressure from the unions for the City to do the same. Mr. Schachter asked Mr. Vortmann if he thought that labor unions controlled the SDCERS Board. Mr. Vortmann replied that he did not think so, but his current impression was that perhaps Webster thought that was the case. Mr. Vortmann recalled having a discussion with Paul Barnett (SDCERS Assistant Administrator), in which Barnett stated that "the Saathoff faction," referring to Ronald Saathoff (SDCERS Board member) was very powerful. Mr. Vortmann recalled Barnett speaking about Saathoff in particular because he had a forceful personality and was more knowledgeable than the other Board members regarding pension issues. Mr. Vortmann described Saathoff as a dominant figure who was very persuasive, but not controlling.

Mr. Vortmann reviewed the August 3, 2001 BRC Minutes (Exhibit 10), which state that the pension system was "well funded." Mr. Schachter asked Mr. Vortmann why he had formed that conclusion. Mr. Vortmann recalled thinking that the system was well funded; his

concern for the pension system regarded the deferral of costs. Mr. Schachter asked Mr. Vortmann if he ever questioned why MP1 was needed. Mr. Vortmann recalled that the City was in "financial straits," but Mr. Vortmann could not recall when he learned this information. Mr. Vortmann concluded that MP1 must have been legal, but he was still concerned that MP1 would impose additional liabilities upon future taxpayers. Mr. Vortmann stated that he could not recall what his understanding of MP1 was at the time that the BRC's report was issued, but in hindsight he does not think he understood MP1 at all. The only information that he could recall regarding MP1 was that it resulted in the City not paying the full expense it was incurring. Mr. Schachter asked Mr. Vortmann if he recalled anything about a trigger being a component of MP1. Mr. Vortmann responded that he could not recall any conversations regarding the details of the trigger while he was on the BRC; he learned that information subsequently while on the SDCERS Board. Mr. Vortmann felt he had only scratched the surface regarding the problems within the pension system when the BRC's report was issued. In hindsight, Mr. Vortmann thought that the pension system's problems were much larger than they had appeared at the time that the BRC's report was issued. Mr. Schachter asked Mr. Vortmann if he thought that he was being misled or if he thought that things were not told to him that should have been. Mr. Vortmann replied that he did not get that impression and he had no reason to believe that was the case. Mr. Vortmann stated that at the time that he was investigating the pension system in connection with the BRC's report, he was naive regarding pension issues and so he may have accepted simplistic answers from Webster or Ryan.

Mr. Vortmann reviewed an email from Webster, dated December 27, 2001 (Exhibit 11); a copy of Mr. Vortmann's "Personal Draft Conclusion," dated December 28, 2001 (Exhibit 12); and an email from Webster to Mr. Vortmann dated December 30, 2001 (Exhibit 13). Mr. Schachter noted that the email from Webster, dated December 27, 2001 (Exhibit 11), stated that "after 40 minutes of discussions/debating/etc. I got almost no where with Dick . . . he's ready for battle and will defend his turf." Mr. Schachter asked Mr. Vortmann to what the email was referring. Mr. Vortmann could not recall that specific conversation, but he stated that he and Webster had debated what figures should be used in the pension section of the BRC's report. Mr. Schachter asked Mr. Vortmann to discuss his impressions of Webster. Mr. Vortmann stated that generally, Webster was pleasant, personable, and presumably capable. Mr. Vortmann recalled that Webster was focused on accounting rules and would not focus on information that did not need to be disclosed under the rules. Mr. Vortmann recalled being engaged in heated debates with Webster, especially regarding medical benefits. He thought that the accounting was flawed, because the expenses created by those benefits were not accounted for in the books. Webster said that the accounting rules did not require that type of disclosure. Mr. Vortmann felt that even though Webster was technically correct on that point, disclosures to the public should have followed a best practices model. Mr. Schachter asked Mr. Vortmann how Webster responded to his arguments. Mr. Vortmann replied that Webster would focus only on what the accounting rules required.

Mr. Vortmann reviewed a fax he sent to Webster, dated December 30, 2001 (Exhibit 14), in which he wrote that he was "more interested in financial disclosure." Mr. Schachter asked Mr. Vortmann what he meant by that. Mr. Vortmann stated that he could not recall what he was referring to, but he recalled being concerned about the fiscal health of the City and that the City needed to acknowledge its pension and healthcare liabilities. Mr. Vortmann could not recall delving into third-party disclosure issues, such as, disclosures to underwriters.

Mr. Vortmann also reviewed an email he received from Webster, dated January 2, 2002 (Exhibit 15). The email seemed to be responding to Mr. Vortmann's fax (Exhibit 14), but Mr. Vortmann could not recall what "fax on disclosure" Webster was referring to.

Mr. Vortmann reviewed an email he received from Grissom, dated March 13, 2002 (Exhibit 16). Mr. Schachter asked Mr. Vortmann what he had asked Grissom, since Grissom seemed to be responding to a question from Mr. Vortmann in this email. Mr. Vortmann stated that he could not recall the specific question, but that he did have a discussion with Grissom regarding the trigger and what would happen if the trigger was breached. Mr. Vortmann recalled that there were two competing interpretations of the trigger. Saathoff and Cathy Lexin (SDCERS Board member) agreed with Grissom's interpretation of the trigger, which would require increasing the City's contributions to the actuarially recommended rate. Mr. Schachter asked Mr. Vortmann if he had any discussions regarding altering the numbers if the trigger was close to being hit. Mr. Vortmann could not recall any discussions regarding that topic.

Mr. Schachter asked Mr. Vortmann if the BRC's report was modified to shift the tone of the report from negative to more positive. Mr. Vortmann responded that he could not recall how the BRC's report was modified and he could not recall any discussions about those competing approaches. Mr. Schachter asked Mr. Vortmann if he could recall the BRC's report ever being characterized as "gloom and doom." Mr. Vortmann replied that he could not recall any discussions of that sort among the BRC or with Webster or Lincoln Ward (BRC member) in particular. Mr. Vortmann did recall a discussion among the BRC, where it was stated that the report made it seem as though the "sky was falling." Mr. Vortmann could not recall if the report was altered in any way as a result of that. Mr. Vortmann also recalled some general discussions about the tone of the report as various members of the BRC practiced presenting their sections of the report. Mr. Vortmann could not recall who spoke out about the tone of the report, but he did not think that it was April Boling (BRC member). It may have been Ryan, Webster, or Joe Craver (BRC Chairman).

Several emails that seemed to relate to changing the tone of the report were then discussed. Mr. Vortmann reviewed an email from Webster to Ryan, dated January 7, 2002 (Exhibit 17). Mr. Schachter asked Mr. Vortmann what he thought Webster was referring to when she said that Mr. Vortmann "didn't fall for it." Mr. Vortmann replied that he could not recall. Mr. Vortmann reviewed an email from Webster to City Manager Lamont Ewell, dated January 15, 2002 (Exhibit 18), where Ewell writes that Webster "masterminded this work." Mr. Schachter asked Mr. Vortmann what Ewell was referring to. Mr. Vortmann could only recall that Ewell may have been referring to something that occurred at a BRC meeting.

Delay of the Blue Ribbon Committee Report

Mr. Vortmann reviewed the BRC Work Plan (Exhibit 19). Mr. Schachter asked Mr. Vortmann if he recalled receiving this document. Mr. Vortmann stated that he could not recall this Work Plan in particular, but that it was the type of document that the BRC worked with. Mr. Vortmann could not recall who prepared the document. Mr. Schachter noted that according to the Work Plan, the BRC's report was scheduled to be issued in September 2001. Mr. Vortmann recalled that September 2001 was when he thought the report would be completed.

Mr. Schachter asked Mr. Vortmann if the need to be cognizant of the report's impact on the City's credit ratings was discussed at BRC meetings. Mr. Vortmann replied that that would have been talked about, but he was not aware of any specific conversations or anyone explicitly bringing this up with him. The impact that the BRC's report could have on rating agencies was not a factor that he considered while he drafted the pension section of the BRC's report.

Mr. Vortmann reviewed another draft of the BRC's report entitled "Employee Retirement Benefit Liabilities," dated August 30, 2001 (Exhibit 20); Webster's handwritten memo dated August 31, 2001 (Exhibit 21); an email that Webster sent to Mr. Vortmann on September 4, 2001 (Exhibit 22); an email from Hughes to Craver, dated September 5, 2001 (Exhibit 23); and a letter that Mr. Vortmann wrote to the BRC, dated April 29, 2002 (Exhibit 24). Mr. Schachter asked Mr. Vortmann to discuss Webster's opinions regarding pension issues. Mr. Vortmann replied that Webster agreed with him regarding the problems created by not sufficiently funding the system. Mr. Schachter asked Mr. Vortmann whether the comments he had received from Webster regarding the BRC report were similar to those contained in Exhibit 22. Mr. Vortmann stated that Webster would review his presentations and the pension section of the BRC's report that he authored. Ms. Vortmann recalled that Webster would pick on many small details. Mr. Vortmann felt that she was being precise and was probably correct.

Mr. Schachter asked Mr. Vortmann if the BRC's report was reaching its final stages in September 2001, when Hughes sent her September 5, 2001 email (Exhibit 23). Mr. Vortmann replied that at that point, the BRC's report was pretty close to being a final product, except for certain sections of the report that were being developed at a slower pace. Boling's section regarding deferred maintenance was taking a long time. Ms. Arnini showed Mr. Vortmann the August 17, 2001 BRC Minutes (Exhibit 25), which stated that certain aspects of Boling's section would not be completed until later in the year. Mr. Schachter noted that Webster's handwritten note (Exhibit 21) and Mr. Vortmann's letter, dated April 29, 2002 (Exhibit 24), seemed to reflect a concern regarding the Ballpark Offering and the timing of the BRC's report. Mr. Vortmann stated that the Ballpark Offering may have been discussed, but he could not recall those conversations. Mr. Vortmann's only recollection regarding the reason for the delay of the issuance of the BRC's report was Boling's section taking more time than was anticipated. Mr. Vortmann also recalled that there was a period of time around Christmas 2001, where "it seemed we weren't getting anywhere." Mr. Schachter asked Mr. Vortmann why he had referred to the concerns about the Ballpark Offering being over in his April 29, 2002 letter (Exhibit 24). Mr. Vortmann could not recall why he included that in the letter. Mr. Vortmann recalled that he had written Exhibit 24, because the individuals who read the report were not sufficiently concerned. Mr. Schachter asked Mr. Vortmann to review the August 31, 2001 BRC Minutes (Exhibit 26) to see if they refreshed his recollection as to why Webster's notes from that meeting (Exhibit 21) mentioned the Ballpark Offering. Mr. Vortmann stated that he was not sure why the August 31st meeting triggered Webster's memo. He thought that perhaps the Ballpark Offering was not discussed at the August 31st meeting, but that Webster had included it in her notes as a thought to herself. Mr. Vortmann could not recall any discussions about the timing of the report or that it would have been better to wait until the Ballpark Offering was issued before the report was released. There were discussions regarding some future financings because that was part of a separate section that was analyzed for the BRC's report. Mr. Schachter asked whether the events of September 11, 2001, caused the delay of the issuance of the BRC's report.

Mr. Vortmann stated that was not the case. Mr. Vortmann also reviewed the December 21, 2001 BRC Minutes (Exhibit 27), which indicate that the first draft of the report was distributed at that meeting. In response to seeing the December 21, 2001 BRC Minutes (Exhibit 27), Mr. Vortmann stated that he could not begin to understand why the report was delayed until February 2002. Mr. Schachter asked Mr. Vortmann if there was a sense that the BRC's report would be damaging to the City. Mr. Vortmann replied that the BRC felt that the report would be benign. While his section of the report regarding pension issues would be negative, the report taken as a whole could have been perceived as being positive.

Mr. Vortmann reviewed an email from Ward to Boling and Webster, dated January 2, 2002 (Exhibit 28). Mr. Schachter pointed out that the BRC's report impacting the City's bond ratings was mentioned. Mr. Schachter asked Mr. Vortmann if he had any conversations regarding the City's bond ratings with Ward. Mr. Vortmann could not recall any but that it would not surprise him if they had occurred because they had many sidebar conversations. Mr. Schachter asked Mr. Vortmann if he could recall the BRC discussing the effect of the report on rating agencies. Mr. Vortmann recalled that there were some discussions about the tone of the report and how a "the sky is falling" theme prevailed, but that was all that he could recall.

Mr. Vortmann reviewed an email from Grissom to Pierce entitled "RE: Ballpark," dated February 19, 2002 (Exhibit 29). Mr. Schachter asked Mr. Vortmann if he could explain the exchange regarding the Ballpark financing in the email. Mr. Vortmann replied that he had no idea why Grissom and Pierce were discussing the Ballpark bonds, but he guessed that there were some concerns about that topic, perhaps because the actuarial valuation issued in February resulted in the funding ratio hitting the trigger. Mr. Schachter asked why Grissom or Pierce would need to act because of the bonds. Mr. Vortmann suggested that perhaps something needed to be done before the bonds were purchased by Merrill Lynch. Mr. Schachter asked Mr. Vortmann what Bob Blum (SDCERS counsel) was directed to stop working on according to the email. Mr. Vortmann stated that he had no idea to what that was referring.

Response to the Blue Ribbon Committee's Report

Mr. Vortmann recalled that the BRC made a presentation to the Mayor on Valentine's Day 2002 and to the Rules Committee on February 27, 2002. The Mayor was presented with the BRC's findings first so that the BRC could incorporate the Mayor's comments prior to the report becoming a public document. Mr. Schachter asked Mr. Vortmann who was at that meeting. Mr. Vortmann could not recall, except that members of the Mayor's staff were present. Mr. Schachter asked Mr. Vortmann how the Mayor reacted to the BRC's presentation. Mr. Vortmann could not recall, except that the Mayor stated that he appreciated the effort put forth by the BRC.

Mr. Vortmann reviewed a letter he wrote to Mayor Murphy, dated March 4, 2002 (Exhibit 30). Mr. Schachter asked Mr. Vortmann why he wrote the letter. Mr. Vortmann replied that he wanted to correct the BRC's report and he wanted to discuss his conclusions with the Mayor privately so as to not embarrass the BRC. Mr. Vortmann also recalled that the BRC had decided that a consensus would be reached and that a minority report would not be developed, and so he felt compelled to write this letter to express his concerns. Mr. Schachter asked Mr. Vortmann if he had ever received a response to this letter. Mr. Vortmann could not recall

receiving one. Mr. Schachter asked Mr. Vortmann if he ever followed up on the letter when he did not receive a response. Mr. Vortmann stated that he did not, because "that was not his style." Mr. Schachter asked Mr. Vortmann what contact he had with the Mayor and his staff. Mr. Vortmann could only recall one conversation with John Kern (Mayor Murphy's Chief of Staff), possibly regarding a pension issue or Mr. Vortmann's reappointment to the Board.

Mr. Vortmann reviewed the Manager's Report that was written in response to the BRC's report, dated March 18, 2002 (Exhibit 31). Mr. Schachter asked Mr. Vortmann what his reaction was to the Manager's Report, particularly how the pension issues were being delegated to SDCERS. Mr. Vortmann recalled that he did not have a problem with that approach, because SDCERS personnel were the experts regarding pension issues. Mr. Vortmann stated that it was problematic that SDCERS did not respond to the BRC's report in a timely manner. Mr. Vortmann recalled that SDCERS finally developed their response to the BRC's report a year after it was delegated that task. Mr. Vortmann could not recall why SDCERS took so long to respond to the BRC's report. Mr. Vortmann stated that he did not know if SDCERS personnel had ulterior motives, but he is now suspicious about everything. Mr. Vortmann expressed his belief that it was SDCERS responsibility to tell the City how much money it needed to contribute to the system. That was how the process was supposed to work, instead Manager's Proposals governed the City's contributions. Mr. Vortmann stated that the response to the BRC's report was not the hard-hitting response that Mr. Vortmann had anticipated.

Mr. Vortmann reviewed a letter he wrote to Mayor Murphy, dated April 16, 2002 (Exhibit 32). Mr. Vortmann recalled that the day before he wrote this letter, April 15, 2002, a presentation was made to the City Council. At that meeting, the BRC's recommendations were discussed, some legitimate questions were asked by Council members, and some Council members attacked the BRC's recommendations. For example, Councilmember Donna Frye disagreed with some recommendations regarding environmental issues. Mr. Vortmann could not recall who else attacked the BRC's report. Mr. Vortmann stated that at first it seemed that the City was going to pay attention to the BRC's report, but in the end that was not what occurred. Mr. Schachter asked Mr. Vortmann if he had received a response to the April 16, 2002 letter. Mr. Vortmann could not recall receiving a response, but he may have received a letter simply saying "thank you very much for making your presentation."

The Failure to Use the Updated Actuarial Report in the BRC's Report

Mr. Vortmann reviewed a letter from Rick Roeder (SDCERS Actuary), which seemed to be a cover letter for the Annual Actuarial Valuation, dated February 12, 2002 (Exhibit 33). Mr. Vortmann also reviewed an email from Webster dated February 12, 2002, which discussed the Actuarial Valuation (Exhibit 34). Mr. Schachter asked Mr. Vortmann if he had received the Actuarial Valuation. Mr. Vortmann responded that it would have been logical for him to have received the Actuarial Valuation with an agenda for a Board meeting.

Mr. Vortmann reviewed a letter that he wrote to Frederick Pierce (SDCERS Chairman) dated February 18, 2002 (Exhibit 35). Mr. Vortmann recalled that he wrote this letter in an effort to understand the Actuarial Valuation. Mr. Vortmann could not remember why he asked the questions contained in the letter, but he recalled that he was concerned about the treatment of the *Corbett* litigation. Whether the *Corbett* litigation was contingent was a topic frequently discussed at SDCERS Board meetings. Vortmann felt that *Corbett* was clearly a

liability and that it was not contingent. In his opinion, the *Corbett* liabilities were only being deferred. Thus, those liabilities should have been quantified in the funding ratio calculation, even though it would reduce the funding ratio. Over time, he became vocal about the disclosure of the *Corbett* litigation, but that SDCERS voted not to disclose the *Corbett* liabilities. The decision not to disclose the *Corbett* liabilities had something to do with how the liabilities were interest-free, to the best of Mr. Vortmann's recollection. Mr. Schachter asked Mr. Vortmann if he was alarmed about problems within the pension system when he wrote the February 18, 2002 letter. Mr. Vortmann stated that could not recall feeling alarmed. Mr. Vortmann could not recall what "pushed him to see the tip of the iceberg" regarding the pension system's problems or when he realized the magnitude of the problems within the pension system. Mr. Schachter asked Mr. Vortmann if he received a response to this letter or to the questions he raised regarding page 17 of the Actuarial Valuation. Mr. Vortmann could not recall if Pierce gave him a response. If the letter was answered, Pierce would have directed Grissom to reply by email or telephone. Mr. Vortmann questioned why the Actuarial Valuation stated that actuarial contributions were being made when that was not the case.

Using a calendar, Mr. Vortmann was able to create a timeline of the events that occurred from the date of the issuance of the Actuarial Valuation to the date of the letter that Mr. Vortmann wrote:

- Tuesday, February 12, 2002: Actuarial Valuation was issued.
- Thursday, February 14, 2002: BRC met with the Mayor.
- Friday, February 15, 2002: SDCERS Board meeting took place and the Actuarial Valuation was discussed. Mr. Vortmann was not present for this meeting.
- Monday, February 18, 2002: Mr. Vortmann wrote his letter.

After creating the timeline, Mr. Vortmann concluded that he probably had not reviewed the Actuarial Valuation prior to presenting the pension section of the BRC's report to the Mayor. Mr. Vortmann recalled that typically he would receive an agenda and any reports that would be discussed at the next Board meeting approximately a week before the meeting was scheduled to be held. Mr. Vortmann's practice was to review those materials the weekend before the Board meeting, but he recalled that he had missed the meeting at which the Actuarial Valuation was discussed and he was trying to catch up the following weekend. That resulted in the conclusion that he reviewed the Actuarial Valuation on February 16 or 17, 2002. Mr. Schachter asked why the Actuarial Valuation was not included in the BRC's final report. Mr. Vortmann stated that after the BRC's report was presented to the Mayor, he thought that the BRC's work was complete since it was the Mayor who had commissioned the report. Additionally, the BRC's report did not need to be changed because it predicted that the funding ratio would decrease.

Mr. Vortmann reviewed an email he wrote to Webster, dated February 19, 2002 (Exhibit 36). Mr. Schachter asked Mr. Vortmann why he had written this email. Mr. Vortmann could not recall, but it may have been triggered by the new Actuarial Valuation.

Mr. Vortmann reviewed a letter from Roeder to the Service Purchase Task Force, dated February 19, 2002 (Exhibit 37). Mr. Schachter asked Mr. Vortmann if he has ever seen the

letter. Mr. Vortmann replied that he could not even recall the existence of the Service Purchase Task Force.

Mr. Vortmann reviewed the SDCERS Experience Investigation, dated May 15, 2002 (Exhibit 38). Mr. Schachter asked Mr. Vortmann what the document was. Mr. Vortmann replied that it was an actuarial study that was conducted to see if the previous year's actuarial assumptions were correct. He could not specifically recall this report, but he was sure that he had received it.

Manager's Proposal 2

Mr. Vortmann reviewed a letter that he sent to Grissom, dated February 20, 2002 (Exhibit 39). Mr. Schachter asked Mr. Vortmann what "cost savings" regarding the Manager's Proposal Mr. Vortmann was referring to in the second paragraph of the letter. Mr. Vortmann stated that he could not recall what that was a reference to, but he could have been referring to "cost savings" to the City. Mr. Schachter asked Mr. Vortmann what he recalled regarding the absence of the SDCERS actuary, which was referred to in the fifth paragraph of Mr. Vortmann's letter. Mr. Vortmann recalled that several SDCERS Board meetings were scheduled, but the actuary could not attend any of them because of scheduling conflicts. After reviewing this letter, Mr. Vortmann also recalled that actuarial reports were "drafts" that could be accepted or rejected by the Board.

Mr. Vortmann reviewed a memorandum from Pierce to City Manager Michael Uberuaga, dated May 13, 2002 (Exhibit 40). Mr. Schachter asked Mr. Vortmann if he could recall a Meet and Confer occurring during this time period. Mr. Vortmann replied that he could not.

Mr. Vortmann reviewed a letter that he addressed to Dennis Gibson (Mayor Murphy's Senior Policy Advisor), dated June 10, 2002 (Exhibit 41). Mr. Vortmann recalled that Gibson called him to ask him to support MP2. He also recalled that MP2 was discussed in a series of meetings involving Uberuaga, Gibson, and Bruce Herring (Deputy City Manager). Mr. Vortmann recalled that he was present when Uberuaga told the Board that a Meet and Confer had been conducted where wage and pension benefits were discussed. Mr. Vortmann recalled that the proposal would reduce the trigger established under MP1 to 75%, Mr. Vortmann was stunned by that proposal and he did not think that it was appropriate for the Board to be involved in labor negotiations. Mr. Schachter asked Mr. Vortmann who spoke out against MP2. Mr. Vortmann replied that Diann Shipione and possibly Ray Garnica, both SDCERS Board members, spoke out against the proposal. Pierce may have also opposed the proposal. Mr. Schachter asked Mr. Vortmann if he asked any questions after Uberuaga made his presentation. Mr. Vortmann stated that he did not because he thought that the first meeting was just a briefing; a special meeting was called to discuss MP2 further. Mr. Schachter asked Mr. Vortmann how he thought SDCERS would benefit from MP2. Mr. Vortmann stated that "there was nothing in MP2 for SDCERS." Mr. Schachter asked Mr. Vortmann what terms he recalled from MP2. Mr. Vortmann stated that he recalled changing the trigger and increasing the City's contributions by 0.5%. Mr. Vortmann recalled that the fiduciary duties of the Board were discussed, but could not recall specifically what was discussed in connection MP2. Mr. Schachter asked Mr. Vortmann to discuss his impressions of Shipione. Mr. Vortmann stated that Shipione was very controversial. He had tried to speak to Shipione but she alienated others; she would make

extreme statements (for example, calling people crooks) and was counterproductive. She was very disruptive and would dominate discussions despite not being well informed. Mr. Vortmann stated that Shipione may have been seeking retribution because Mayor Murphy had prevented her husband's real estate proposal from going forward.

Mr. Vortmann reviewed a presentation entitled "Actuarial Information RE: Manager's Proposal," dated June 12, 2002 (Exhibit 42). Mr. Schachter asked Mr. Vortmann if he was present when this presentation was given. Mr. Vortmann could not recall having seen the presentation, but he believes that Roeder was trying to make the point that the funding ratio would decrease. Mr. Schachter asked Mr. Vortmann if he could recall Roeder or Blum's views regarding MP2. Mr. Vortmann recalled that Roeder was originally opposed to the proposal and that Blum was "pretty forceful in saying that there were fiduciary duties issues" regarding MP2.

Mr. Vortmann reviewed a letter that he addressed to Pierce and Grissom, dated June 24, 2002 (Exhibit 43). Mr. Vortmann recalled that he wrote this letter in response to a presentation Herring made to the Board. Mr. Vortmann recalled Herring saying that if the Board had any questions, they should contact him. Mr. Schachter asked Mr. Vortmann if he thought that the benefit increases were contingent on the Board approving the contribution relief. Mr. Vortmann stated that he "absolutely" thought that was true. He recalled being told that the benefits were contingent by Lexin, Herring, Uberuaga, and Saathoff. Mr. Schachter asked Mr. Vortmann if he received a response to the letter. Mr. Vortmann stated that Herring responded to the letter, but he felt that Herring was being disingenuous. Mr. Vortmann could not recall the details of why he thought Herring was being disingenuous.

Mr. Vortmann reviewed a memo from Herring to Grissom, dated July 1, 2002 (Exhibit 44). Mr. Schachter pointed out that the memo stated that MP2 would lower the trigger from 82.3% to 75%. Mr. Vortmann stated that the memo was accurate. Mr. Vortmann then stated that neither he nor Shipione was present at the SDCERS Board meeting at the time that the proposal was approved. They both needed to leave early. As a result of that, Mr. Vortmann tried to vote by proxy, but Pierce stated that was not permitted. Mr. Vortmann stated that he now believes that the meeting may have been purposefully dragged out so that he and Shipione were not present for the vote. Mr. Schachter asked Mr. Vortmann if he could recall discussions regarding the likelihood that the trigger would be met. Mr. Vortmann recalled that when MP2 was approved he knew that the trigger had not yet been hit, but his understanding was that most people thought that it would be hit.

Mr. Vortmann reviewed the July 11, 2002 SDCERS Board Minutes (Exhibit 45). Mr. Schachter asked Mr. Vortmann why the Board sought indemnification in connection with its approval of MP2. Mr. Vortmann replied that indemnification became an issue early on when Michael Aguirre, prior to being elected City Attorney, stated to the Board that a lawsuit would be filed if MP2 was approved. Mr. Schachter asked Mr. Vortmann if he knew how Aguirre knew about MP2 being proposed to the Board. Mr. Vortmann replied that there were rumors that Aguirre and Shipione were linked. Mr. Vortmann remembered thinking at the time that Aguirre did not understand the nuances of the pension system. Mr. Schachter asked Mr. Vortmann if he knew what "was in it" for Aguirre to raise this issue. Mr. Vortmann replied that he did not know, but there was a rumor about ties between Aguirre and Michael Conger, plaintiff's counsel in the *Gleason* litigation. Mr. Schachter asked who first raised the point that indemnification

should be sought. Mr. Vortmann could not recall. Mr. Schachter asked Mr. Vortmann if he knew why Shipione had left the July 11, 2002 meeting. Mr. Vortmann stated that he did not.

Mr. Schachter asked Mr. Vortmann what occurred at the July 11, 2002 meeting. It was Mr. Vortmann's understanding that MP2 had been approved at the July 11, 2002 meeting, as long as certain contingencies were met. These contingencies were the issuance of a legal opinion stating the fiduciary duties of the Board were not violated, the drafting of a written agreement memorializing the proposal, and possibly also Roeder's approval of MP2. The proposal that was approved was referred to as the "Saathoff amendment." Mr. Vortmann recalled learning this information over the phone, but he could not recall to whom he was speaking. By the November 15, 2002 SDCERS Board meeting, MP2 had already been approved and so that was not discussed anew and the vote taken at the November 15, 2002 meeting was only regarding whether the contingencies had been met. Mr. Vortmann felt that MP2 was "not as bad as it could have been"; in fact, it was a "victory." Mr. Vortmann thought that Uberuga would be able to get whatever he demanded and that since the proposal had been amended to provide that the trigger would not be set at 75%, the proposal was better than what he had anticipated. Mr. Vortmann stated the requisite number of Board members needed to approve MP2 were already in agreement with the proposal when Uberuga gave his initial briefing to the Board.

Mr. Vortmann stated that when the economic consequences of maintaining MP1 were compared to the consequences of approving MP2, MP1 may have been better economically. Mr. Vortmann admitted that this was true because even if the less erroneous interpretation of the trigger under MP1 controlled, SDCERS would have received greater contributions from the City than under MP2. Nevertheless, that conclusion could only be made with the benefit of hindsight, because when MP2 was approved it was not certain that MP1's trigger would be hit. Mr. Vortmann went on to say that even if the MP1 trigger was hit, there was no guarantee that the City would be able to contribute the requisite amount to the system, and any litigation regarding the interpretation of the trigger would result in the City's contributions being delayed. Mr. Vortmann reviewed a letter written by Roeder and addressed to Grissom, dated November 7, 2002 (Exhibit 46). In the letter Roeder stated that it was likely the trigger would be hit so it would be best to hold the City to MP1. Mr. Vortmann stated that he felt that information was true, but he felt there was "no hope" of the City being able to gather the funds that would be required if MP1's trigger was hit.

Mr. Vortmann reviewed a newspaper article from the San Diego Daily Transcript, entitled "Concerns raised over city's ability to finance employee retirement fund," dated December 6, 2002 (Exhibit 47). Mr. Schachter directed Mr. Vortmann to the second page of the article which stated that Mr. Vortmann thought the deal was a "fair trade." Mr. Schachter asked Mr. Vortmann if he recalled making that statement. Mr. Vortmann replied that he could not. Mr. Vortmann could not recall if he really believed at that the time or if he was saying that the deal was fair for political reasons.

Purchase of Service Credits and Presidential Leave

Mr. Vortmann reviewed the Audit Report addressed to him which discussed the Purchase of Service Credits by Saathoff, dated February 27, 2004 (Exhibit 48). Mr. Vortmann recalled that the City was conducting audits and this was one such report. Mr. Vortmann

recalled that the auditor questioned whether Saathoff's benefits were properly processed and they recommended the Board develop a process so this would not occur again. Mr. Vortmann stated it was strange that Saathoff did not submit the paperwork and the payments required to purchase his service credits on time. Mr. Vortmann speculated that maybe Saathoff had forgotten to file the paperwork or he could not afford to pay for the credits at that time. Mr. Schachter also asked Mr. Vortmann if he recalled any discussions regarding Presidential Leave. Mr. Vortmann stated he had never heard that term before.

Use of Surplus Earnings and Reserves

Mr. Schachter gave Mr. Vortmann an email from Webster to Grissom, dated December 3, 2001 (Exhibit 49) and asked what he thought "base needs" was a reference to. Mr. Vortmann stated that it was a reference to the amount of money that would be required to satisfy the liabilities in the waterfall. It appeared to Mr. Vortmann that Webster was referring to a report in the email which would be available in the SDCERS agenda book.

Mr. Vortmann reviewed an email that he authored dated December 26, 2001 (Exhibit 50), which includes his comments to the BRC's report as an attachment. Mr. Vortmann wrote that budget surpluses should be saved for a "rainy day." Mr. Schachter asked Mr. Vortmann from whom he had received that information. Mr. Vortmann could not recall, but stated it may have been Ryan or Webster. Mr. Schachter asked Mr. Vortmann why he had suggested that an orientation program regarding the pension system be established for City Council members. Mr. Vortmann recalled that since he could not understand the complexities of the system, he did not think the City Council could either. Mr. Vortmann recalled that the pension system was very complex and convoluted. Mr. Vortmann recalled asking for a simple break out of "where the money is coming from and where the money is going." Instead he received from SDCERS staff a budget book that exhibited a complex system involving enterprise funds and money flowing back and forth among different reserves. Mr. Vortmann could not imagine how the City Council could understand the information contained in the budget without any training.

Knowledge of Investments

Mr. Vortmann reviewed an email from Webster to Ryan, dated October 9, 2001 (Exhibit 51). Mr. Vortmann could not recall ever receiving the email. Mr. Schachter asked Mr. Vortmann if he could recall any specific conversations regarding the performance of investments. Mr. Vortmann stated that he could not. Mr. Schachter asked if Mr. Vortmann would expect the information contained in the email to be relayed to the Board. Mr. Vortmann stated that the figures in the email seemed to be "midstream" and so it may not have been shared with the Board. Mr. Vortmann also noted that the email was unclear as to whether the figures represented realized or total earnings. Realized earnings represent the funds received from the sale of investments or the receipt of dividends. Total earnings represent the system's cash on hand and the value of the stock owned by the system. Mr. Vortmann noted that the funds used to pay for items in the waterfall came from excess earnings, which was a function of realized earnings only. Therefore, if stocks were sold, realized earnings could be inflated so that additional funds could be available to fund the waterfall. Mr. Vortmann clarified that he was not alleging that had occurred. Mr. Schachter asked Mr. Vortmann what information was revealed at

SDCERS Board meetings regarding investments. Mr. Vortmann recalled that there was an investment report at every Board meeting. Mr. Schachter asked Mr. Vortmann if he could recall whether the system's investments were doing poorly. Mr. Vortmann said he was not even sure that the information in the email demonstrated that investments were doing poorly, because SDCERS was doing very well compared to other public funds.

Mr. Vortmann was asked to review an email from Webster to Ryan, dated January 3, 2002, which discussed the decrease of the funding ratio (Exhibit 52). Mr. Schachter asked Mr. Vortmann if he was given this information. Mr. Vortmann stated that he thought he would have had this information as a member of the Board, but not as a member of the BRC. Mr. Vortmann stated that he would not have included this information in the BRC's report because he had completed the pension section of the report in August and he would not have updated it. Additionally, Mr. Vortmann felt this information did not need to be included in the BRC's report because the report already anticipated a drop in the funding ratio.

The Budget

While discussing the budget process in general, Mr. Vortmann stated that the City had the most convoluted accounting system he has ever seen and that he did not even gain an understanding of the budget process until after the BRC's report was released. Vortmann specifically recalled that the City failed to establish long-term budgetary plans (they just developed an annual budget) and this was one of the conclusions contained in the BRC's report. Mr. Vortmann assumed he spoke with Ryan and Webster regarding the budget, since they were his resources within the City for information.

Wastewater

Mr. Vortmann reviewed the August 17, 2001 BRC Minutes (Exhibit 25). Mr. Schachter asked Mr. Vortmann if he was involved in any other issues that were analyzed in the BRC's report. Mr. Vortmann recalled that he assisted Ward with a section regarding water and sewer costs. Mr. Schachter asked Mr. Vortmann if through that work he considered rate structures, or the need to increase rates in order to qualify for certain grants which would lower rates for most homeowners, but increase rates for industrial users, such as Kelco. Mr. Vortmann replied that he had no such recollection. If it was discussed, that would have "hit a nerve," since his company is an industrial user. Mr. Schachter then asked Mr. Vortmann who Ward was and Vortmann replied he was involved in civic matters and that Ward either led or created a group that would conduct audits on City activities, such as the operations of water and sewer.

Remediation

Mr. Schachter invited Mr. Vortmann to suggest ways in which the pension system could be improved. Mr. Vortmann stated that the excess earning concept (which is a "total fiction") should be eliminated to prevent the manipulation of realized earnings. Mr. Vortmann believed that benefit increases needed to be amortized over a five-year period rather than 30-40 years so that a realistic assessment can be made as to whether the City can afford increased benefits. Long-term financial planning should also be developed so that the true costs of benefit increases can be appreciated. Mr. Vortmann also suggested that SDCERS financials be simplified.

Mr. Vortmann does not think the City Council should approve new proposals regarding the pension system unless a legal opinion is provided. Mr. Vortmann stated that the argument could always be made that labor negotiations took place at the 11th hour and so it would be difficult to secure a legal opinion on short notice, but that was no excuse.

Mr. Vortmann referred to his work on the Pension Reform Committee and stated that his thoughts on remediation were encapsulated in that report. Mr. Vortmann stated that the Pension Reform Committee Minority Report he authored also discusses the need to ensure that the 50/50 split regarding the contributions of employers and employees is enforced.

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