

DATE ISSUED: January 31, 2005 REPORT NO. 05-031

ATTENTION: Honorable Mayor and City Council
Docket of January 31, 2005

SUBJECT: Hearing to Review (1) City Compliance with Securities and Exchange Commission (SEC) and Other Subpoenas, (2), the Purging of Files by the City Treasurer's Office (3), and the Seizure of Documents from the Offices of the Former City Treasurer, Human Resources Director and Acting City Auditor

SUMMARY

Issues – Should the City Council accept the preliminary report on the review of (1) City compliance with the SEC and other subpoenas, (2), the purging of files by the City Treasurer's Office and (3) the seizure of documents from the offices of the Former City Treasurer, Human Resources Director, and Acting City Auditor?

Manager's Recommendation – Accept the report.

Other Recommendation(s) – Allow the appropriate authorities to continue and conclude a comprehensive investigation regarding these issues to determine the facts, and report findings and conclusions based on such facts.

Fiscal Impact – None.

BACKGROUND

Recently there have been many allegations and media stories concerning City compliance with subpoenas issued by the Securities and Exchange Commission (SEC) and the United States Attorney's Office (USAO), the seizure of documents from City Official's offices, as well as allegations surrounding the purging of files in the City Treasurer's Office. The Mayor and members of the City Council have requested that the City Manager provide a full and complete report concerning these issues. This report is intended to provide an update on the issues raised in the Mayor's Memorandum dated January 24, 2005, (Attachment 1). It is important to note

that this is an interim report that reflects the facts as known today. Investigations by SEC, the USAO, as well as the City Attorney's Office are ongoing. Conclusions should not be drawn until all fact finding efforts are complete.

DISCUSSION

City Compliance with SEC and Other Subpoenas and Purging of Files by the City Treasurer's Office

On or about February 12, 2004, the City received a voluntary request for documents from the SEC, as well a subpoena from the USAO, requesting documents from January 1, 1996, to the present, concerning a broad range of documents with respect to bond offerings, the pension system, and the City's Annual Finance Reports (CAFR's). (Attachment 2) It is my understanding that this request by the SEC and the subpoena from the USAO was delivered to the City Attorney's Office.

In response to these subpoenas, the City Attorney's Office took the lead in determining a coordinated plan of action which was to include developing a specific protocol for document production. However, until this protocol was developed, all Departments who may have had responsive documents in their possession were advised to preserve a broad range of documents with respect to bond offerings, the pension system, and the City's Annual Finance Reports (CAFR's). In addition, San Diego Data Processing Corporation (SDDPC), in consultation with the City Attorney's Office, began to establish electronic safeguards to ensure that no electronic records were deleted from the City's system. The City Attorney's Office then directed affected staff by electronic mail, to take all necessary steps to immediately preserve and retain all work related documents and electronic mail that may be even remotely relevant to the subject matters. It is also my understanding that the SEC advised SDDPC to alter the City's electronic mail system to suspend automatic deletion of electronic mail on February 17, 2004. On February 20, 2004, SDDPC suspended electronic mail retention policies thereby prohibiting employees from deleting their electronic mail. The City Attorney's Office, in consultation with outside counsel, established a Document Production Protocol for Document Custodians, dated March 9, 2004, ("Protocol") (Attachment 11). It is also my understanding that the Protocol was shared with the SEC. The Protocol specifically describes the types of documents that should be produced, and lists categories of requested documents as well as the describes the procedure to be followed in document production. Over the next month and a half, City employees identified by the City Attorney's Office as Custodians of Records, followed the Protocol in terms of identifying and producing all relevant documents to the City Attorney's Office. From February through May 2004, City departments worked diligently to produce all requested documents following the Protocol, all done in consultation with the City Attorney's Office.

On or about June 3, 2004, SDDPC issued an electronic mail notice that the policy of retaining electronic mail and electronic mail trash had been lifted and that the ability to empty electronic mail trash would be restored on June 4, 2004. (Attachment 3) On June 8, 2004, after receiving an inquiry from the Financing Services Division staff, the City Attorney's Office confirmed that prior restrictions concerning electronic mail had been lifted. In addition, in response to an inquiry concerning the propriety of recycling hard copy documents as well, the City Attorney's Office through electronic mail advised that existing departmental records retention requirements should

now be followed when recycling documents, but that originals or sole copies of documents that are material and related to bond offerings should not be thrown away, particularly on the issues concerning the pension system. However, with respect to all other documents, it was understood that they were to be retained or discarded pursuant to already existing records retention schedules.

At this point, after receiving electronic notification from SDDPC and then after specifically confirming the message with the City Attorney's Office, staff believed that they had been assured that it was no longer necessary to retain all archived electronic or hard copy documents, with the understanding that all originals or sole copies of documents that are material and related to bond offerings should not be thrown away, particularly on the issues concerning the pension system. Between February and May 2004, it is also important to note that significant efforts were taken to back-up existing hard drives of affected employees to ensure that all responsive material would not be inadvertently destroyed.

A City Treasurers Senior Staff Meeting was held on June 10, 2004, and copies of the existing records retention schedules were issued to the City Treasurer's Department staff (Attachment 4). According to the City Treasurer's Office, the need to recycle was especially important for several reasons, including: file space was at a premium; the nature of the work within the division often produced multiple copies of the same document; and, the division was planning to relocate its office space in the near future.

To that end, on October 28, 2004, a memorandum addressed to the Financing Services Division was issued proposing a recycling day "in an effort to organize the Division's document retention and limited storage space". (Attachment 5). Attached to the memorandum were copies of applicable current records disposition schedules, including the City of San Diego General Records Disposition Schedule for Records Common to Most City Departments, the Records Disposition Schedule for the City Treasurer's Office, and the Records Disposition Schedule for the Financial Management Department.

December 10, 2004, was selected as the day to begin the recycling of some of the Financial Services Division documents pursuant to established records retention schedules ("recycling event"). Approximately 4-6 employees of the division's nineteen employees participated in the project. Although no one from the Treasurer's Office appears to have specifically contacted the City Attorney's Office, it was their belief that this event was routine recycling and consistent with the direction given by the City Attorney's Office on June 8, 2004. It is important to note that staff did not view this recycling any differently than how the division had been operating since June 2004, when it received such advice and communication from the City Attorney's Office.

On January 20, 2005, Vinson & Elkins, attorneys for the City, while conducting an interview of a City employee in connection with their work relating to the issuance of an audit letter for the City's independent auditor, KPMG, became aware of the December 10, 2004, recycling event and became concerned that perhaps there may have been a possible loss of documents responsive to the SEC and USAO subpoenas. On January 21, 2005, the morning following their discovery of the recycling event, Paul Maco, an attorney with Vinson & Elkins, contacted City Manager Lamont Ewell and notified him of the potential problem. Mr. Maco advised the City Manager of

certain actions that should be taken to ensure the preservation of documents and recommended an investigation occur to determine if any responsive documents had been lost. These actions are outlined in a memorandum from Mr. Maco to City Manager, Lamont Ewell. (Attachment 6).

On January 21, 2005, an investigator with the the City Attorney's Office and an attorney with Vinson & Elkins, interviewed the staff member of the Financing Services Division concerning the recycling event. The remaining staff members of the Financing Services Division were interviewed by these same parties beginning January 21, 2005, and into the following week. The City Manager's Office asked Vinson & Elkins, in the presence of a representative of the City Attorney's Office, whether it would be appropriate for a witness to be present during the interviews as support for employees if requested. Vinson & Elkins, and the City Attorney's Office agreed that it would be appropriate for Deputy City Manager, Lisa Irvine, to be present at an interview if an employee so desired. As staff was contacted for their interviews, some expressed a general concern of the process, as it was their understanding that they had simply been following the City Attorney's Protocol and now the City Attorney's Office would be involved in the investigative interviews. Eight of the thirteen employees interviewed that day, did in fact request that Lisa Irvine be present during their interviews. The Deputy City Manager did not make any comments during those interviews in which she was present. In all additional interviews, no City Officials were present.

The USAO delivered a subpoena (Attachment 7) on January 21, 2005, to the City Attorney's Office. The Financing Services Division staff did not receive a copy of the subpoena until January 26, 2005. Upon receiving the subpoena staff began compiling all documents and communications concerning the removal, destruction, or "cleaning" of documents belonging to the City pertaining to the removal, destruction or "cleaning" of documents in December of 2004. The production of requested documents is currently in process and is to be completed and submitted to the USAO by February 1, 2005.

Seizure of Documents from Offices of the Acting City Auditor, Human Resources Director and City Treasurer

Another subject that has received much media attention is the taking of documents by the City Attorney's Office from the offices of certain City Officials. On January 13-14, 2005, numerous boxes of records were taken from the offices of various City Officials by the staff of the City Attorney's Office. These include the offices of the Acting City Auditor, the Human Resources Director, and Former City Treasurer. In each case, the City Attorney's Office stated that they were exercising their authority pursuant to City Charter section 40. City Charter section 40 states in part:

The City Attorney shall have charge and custody of all legal papers, books, and dockets belonging to the City pertaining to his office, and, upon a receipt therefore, may demand and receive from any officer of the City any book, paper, documents, or evidence necessary to be used in any suit, or required for the purpose of the office.

While all parties in one form or another objected to the manner in which documents were taken by the City Attorney's Office, they all complied with the City Attorney's demand. It is important to note, that on December 6, 2004, a new City Attorney took office. The above document

request was contrary to the Protocol established by the previous City Attorney. It was the previous City Attorney's position that the SDCERS system was an independent entity with its own legal counsel. The direction given to those individuals who had dual roles, as both City Officials, as well as SDCERS board members, had been to provide all responsive documents obtained in their capacity as SDCERS board members directly to SDCERS counsel and all documents obtained in their capacity as City Officials to City Attorney Office,

In early January 2005, both the Human Resources Director and the Former City Treasurer met with Vinson & Elkins, as well as a representative from the City Attorney's Office, to discuss how files were retained and organized within their respective offices. During these meetings it was made clear to Vinson & Elkins, as well as the representative from the City Attorney's Office, that both the Human Resources Director and the Former City Treasurer were in possession of responsive SDCERS documents that were either determined to be privileged attorney-client documents or duplicate copies of documents that had already been produced to SDCERS counsel per the previous City Attorney's established protocol. Any suggestion that the existence of these documents were unknown to the current City Attorney prior to their being seized by his office would seem to be inconsistent with the facts as we understand them today. Last week, SDCERS filed suit against the City Attorney over the taking of these documents as well as other legal issues surrounding SDCERS.

The City Attorney has contended that these boxes contain documents previously requested, but not produced to the SEC and USAO. However, the written statements of the three City Officials seem to dispute this contention. They contend that they have fully complied with the Protocol for production of documents in response to the SEC and USAO subpoenas. In addition, the memorandum by the Former City Treasurer notes that it was her understanding that the City Attorney's Office originally declined to take possession of the SDCERS documents because it considered SDCERS a separate entity from the City. Accordingly, she received instruction to produce responsive SDCERS documents to the General Counsel for SDCERS. SDCERS General Counsel would then handle the production of documents to both the SEC and USAO, related to SDCERS responsibilities, consistent with the agreed upon Protocol. Rather than attempt to summarize the statements of these three City Officials further, you are strongly encouraged to read their individual statements (Attachments 8-10).

There continues to be an ongoing investigation with respect to these issues.

CONCLUSION

The facts as we currently know them in relation to the subject issues are reflected in this report. Based upon the information currently available, the City Manager's Office believes that City staff has complied or is in the process of complying with SEC and USAO subpoenas for document production as prescribed by the City Attorney's Office Protocol that was developed in March 2004. At the outset of the investigations by the SEC and USFO, and through the present time, the City Attorney's Office has established itself as the office responsible for directing and

handling the document production process related to the SEC and USAO subpoenas. Affected staff (i.e., staff deemed as Custodian of Records by the City Attorney's Office) has operated under the belief that compliance with the City Attorney's Office Protocol is equivalent to compliance with the SEC and USAO subpoenas. Should the City Attorney's Office determine that changes are necessary with respect to its protocol, the City Attorney's Office should notify affected staff and staff will be directed to act accordingly.

For purposes of this report I offer the following observations:

1. Subpoenas from the SEC and USAO were received directly by the City Attorney's Office. Some Senior Management Staff also received subpoenas early in the process and based on the advice of the City Attorney's office did not disseminate these subpoenas to City staff but were advised to await a document production protocol. It is also important to note that the USAO subpoenas received by Management specifically directed them "not to disclose the existence" of the subpoena which was understood to include city staff.
2. The City Attorney's Office, in consultation with outside counsel, established a Document Production Protocol for Document Custodians.
3. City staff followed the Protocol with respect to document production believing that by doing so they were in compliance with the subpoenas. City staff did not receive copies any of the actual subpoenas.
4. The Financing Services Division – City Treasurers Office never received an actual copy of any subpoenas until January 2005, but instead relied upon the City Attorney's established protocol developed March 9, 2004, to guide them in document production.
5. The three City Officials who had documents seized from their offices also believed that they were following the City Attorney's Protocol.
6. The original Protocol developed by the previous City Attorney, did not apply to SDCERS documents, as SDCERS was considered a separate legal entity by the City Attorney's Office. Therefore, production of responsive SDCERS documents was to be directed to SDCERS General Counsel and not the City Attorney's Office.
7. Based on the January seizures of document from the offices of City Officials and subsequent statements by the City Attorney's Office, this protocol appears to have changed.

Once the investigations are completed, a final report will be made to the Mayor and City Council. We realize that these matters continue to be of high interest. The City Manager's Office and impacted departments continue to respond promptly and responsibly in order to conclude the investigations in a timely manner with the appropriate due process.

ALTERNATIVE

Do not accept the preliminary report of (1) City compliance with the SEC and other subpoenas, (2), the purging of files by the City Treasurer's Office and (3) the seizure of documents from the offices of the Former City Treasurer, Human Resources Director, and Acting City Auditor.

Respectfully submitted,

P. Lamont Ewell
City Manager

EWELL/CEM

Note: Attachments are not available electronically. A copy for review is available in the Office of the City Clerk.

- Attachments:
1. January 24, 2005, Memorandum from Mayor Murphy
 2. April 22, 2004, SEC Subpoena
 3. Groupwise Administrator Electronic Mail Notification, June 3, 2004
 4. June 10, 2004, City Treasurer's Senior Staff Meeting Agenda and Attachments
 5. October 28, 2004, File Retention/Disposal Memorandum
 6. Vinson & Elkins Memorandum, January 31, 2004
 7. January 21, 2005, USAO Subpoena
 8. January 18, 2005, Memorandum from the Human Resources Director
 9. January 19, 2005, Memorandum from the Financial Management Director
 10. January 27, 2005, Memorandum from the Acting City Auditor and Comptroller
 11. City Attorney Document Production Protocol, March 9, 2004.