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The New York Times

Sunny San Diego Finds Itself Being Viewed as a Kind of **Enron-by-the-Sea**

John M. Broder. [New York Times](#). (Late Edition (East Coast)). New York, N.Y.: [Sep 7, 2004](#). pg. A.14

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Abstract (Article Summary)

In the summer of 2003, Diann Shipione, an investment adviser at [UBS](#) Financial Services in San Diego and a trustee of the city's employee retirement system, was scanning a prospectus on a proposed San Diego sewer bond issue when alarm bells began to ring in her head.

Important financial information was missing. The prospectus did not mention that the city had for years been shortchanging its public pension fund, leading to an unfunded liability of more than \$1.15 billion, or that the city owed nearly \$1 billion more in health care benefits to retirees and did not have the money. And it implied that the pension fund's actuary had approved the underfunding when Ms. Shipione knew that he had not.

Diann Shipione did not like the way San Diego was handling its employee pension system, and let the world know. [Mike Aguirre] calls the situation "a powder keg." (Photo by Jack Smith for The [New York Times](#))

Full Text (1384 words)

Copyright New York Times Company Sep 7, 2004

In the summer of 2003, Diann Shipione, an investment adviser at [UBS](#) Financial Services in San Diego and a trustee of the city's employee retirement system, was scanning a prospectus on a proposed San Diego sewer bond issue when alarm bells began to ring in her head.

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In a letter to city officials, and in a commentary in the local newspaper, Ms. Shipione blew the whistle.

"I had completely lost confidence in the city's financial decision making," she said in an interview on Wednesday. "I just couldn't let this go forward."

Ms. Shipione's warning began a cascade of events that have led to a legal, financial and political crisis in San Diego, the nation's seventh-largest city, which has long enjoyed a reputation for clean and conservative governance.

The sewer bond sale was postponed. Alarmed bond-rating agencies have significantly downgraded the city's credit rating, raising borrowing costs years into the future. The city was forced to admit that it had misstated its financial condition for the last several years, and it has not yet produced a certified financial statement for 2003. Several senior city officials abruptly resigned. Retired city employees, concerned that they would lose benefits because of mismanagement of the pension fund, sued the city, demanding immediate payments into the fund. Reputable analysts have begun talking openly about the possibility that the city will have to declare bankruptcy, as Orange County did a decade ago.

And the Securities and Exchange Commission and the United States attorney's office in San Diego opened investigations this year into possible fraud in the city's financial statements and potential political corruption. Subpoenas were served on a number of city offices and several people confirmed that they had been interviewed by the F.B.I. in connection with the inquiry.

"This is a powder keg, a major, major problem," said Mike Aguirre, a securities lawyer and former financial fraud investigator for the United States Senate and the Justice Department who is running for San Diego city attorney.

Mr. Aguirre said that the city's inability to produce a credible financial statement made it impossible to know just how severe the crisis was. He said that a corporation that behaved like the City of San Diego would be delisted from the stock exchanges. He suggested that the best solution might be reorganization under Chapter 9 of the federal bankruptcy law to allow the city to rescind pension benefits.

Mr. Aguirre blamed San Diego's laid-back civic culture in which a handful of influential businessmen, union leaders and political figures called the shots while issuing reassurances to the public that everything was on the up-and-up.

"The basic story is that San Diego has become a thoroughly corrupt community in which the power players cut the deals, you don't ask any questions, and everybody gets what they want," Mr. Aguirre said. "People don't realize that one of the largest cities in the United States is on the verge of bankruptcy, and it's on the verge because of a massive amount of local corruption that has resulted in the thorough mismanagement of city finances."

San Diego's mayor, Dick Murphy, who is up for re-election this year, declined to be interviewed for this article. His chief of staff, John Kern, acknowledged that the city's budget was under stress for a variety of reasons. But he asserted that the city was on sound fiscal footing.

"We are not on the verge of bankruptcy," Mr. Kern said in an interview in his city hall office. He said that the city's budget problems had many causes, including cutbacks in payments from the state, which is facing its own budget crisis. He also cited the poor performance of the stock market after 2000, cutting the value of the city's pension accounts. He said that last fall's devastating wildfires had cost the city millions of dollars and required substantial new investments in firefighting equipment.

He also said that hundreds of other public and private pension systems were suffering problems similar to San Diego's because of the stock market and the rising cost of benefits.

He acknowledged that the city had made a "mistake" in underfunding its pension programs, but said the practice began in 1996, under a former city administration. That year the city essentially borrowed millions from its pension plans to cover the cost of holding the Republican National Convention and has continued the practice to cover operating costs and underwrite numerous city projects.

He also acknowledged inadvertent "errors" in the city's recent financial statements.


Mr. Kern said that the city's actions were not illegal and that he understood that the federal investigations center on what he described as financial disclosure issues and not criminal behavior.

"The fundamental fact of the city and its finances is that it can meet its obligations, and we are working through the issues as carefully and methodically and expeditiously as we possibly can," Mr. Kern said.

Deborah Hartman, a spokeswoman for Carol Lam, the United States attorney for San Diego, declined to comment on her office's investigation.

Nels Mitchell, associate regional director of the Securities and Exchange Commission, said the agency did not confirm or deny the existence of any investigation.

Carl DeMaio of the San Diego Citizens' Budget Project, a nonpartisan watchdog group that has long been critical of the city's financial management, said the city's wounds were almost entirely self-inflicted and not a result of state cutbacks or the stock market. Mr. DeMaio said that officials had deceived residents about the city's fiscal condition for years but got in trouble when they issued misleading statements in recent bond offerings.

"If the U.S. attorney finds the city knowingly misled investors with  Enron-like accounting, we could see both a large civil liability and criminal indictments," Mr. DeMaio said. "I believe that people for political and personal gain built this Ponzi scheme, and it's coming home to roost this year."

Among the chief causes of the long-term instability of the city's employee retirement fund was a pair of decisions in 2002 to add benefits for future retirees while reducing the city's annual contribution to the funds. Among the most costly was a program called a deferred retirement option plan, or DROP, which allows a worker to defer retirement and build up a special account earning 8 percent interest and a 2 percent annual cost-of-living adjustment. Such programs have touched off investigations in Philadelphia, Houston and Milwaukee.

That action prompted an impassioned warning from Ms. Shipione, who was one of only 2 of 13 members of the San Diego City Employees' Retirement System board to vote against the plan. She said that DROP would entitle a worker earning an average of \$50,000 to collect a lump sum of more than \$300,000 at retirement, along with all his or her other benefits. A higher-paid employee could walk away with close to \$1 million.

At the same time, the city approved a reduction in payments into the retirement fund.

Ms. Shipione went before the City Council in November 2002 and said the changes were a recipe for disaster.

"It made no sense fiscally, no sense," she said. "The city has never been able to afford this kind of retirement program. I told them, 'This is corrupt.'"

City officials ignored her warnings and approved the benefit increases and the underpayments to the account, then glossed over them in bond issues last year. They are reaping the whirlwind today.

"I saw this happen in Orange County and I realized I had to speak up," Ms. Shipione said. "I let the retirement board know, I let the mayor and the council know, and no one appeared interested. The city basically did it to itself."

[Photograph]

Diann Shipione did not like the way San Diego was handling its employee pension system, and let the world know. Mike Aguirre calls the situation "a powder keg." (Photo by Jack Smith for The  New York Times)

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