

Nollenberger, who was at that time the Chief Administrative Officer of the City. In order to resolve the contract, Nollenberger knew the City needed to provide additional compensation of another one-quarter or one-half percent or so, but was unwilling to offer that amount as a percentage of salary because of the effect it would have on his negotiations with other bargaining units and because of the compounding effect of a percentage increase on subsequent negotiations, which he referred to as "the creep." He wanted any additional compensation to be in the form of a specific dollar amount, not a percentage of salary. Nollenberger offered to include in the contract a specific dollar amount which would be paid as deferred compensation.

3. I was previously appointed to the City Deferred Compensation Commission by City of Duluth Mayor Doty. I was aware the City was interested in increasing participation in Deferred Compensation and shared the City position that deferred compensation was good public policy and encouraged personal savings. Some employees did not participate out of fear of the program. Having a contract feature of deferred compensation would get all employees participating and the assumption was it would encourage further personal savings. However, I was also concerned that I negotiate no contractual provision that harmed my members. I specifically asked Nollenberger whether amounts he offered to pay to employees as deferred compensation would be considered regular, PERA eligible salary, and was assured on more than one occasion by Nollenberger that they would be.

4. Deferred compensation was depicted on pay stubs inconsistently. It was described on the Gross Earnings side of the stub simply as "DEF COMP" or "DEF WAGES" and the amount would be represented as one number. It was referred to on the

Taxes and Deductions side as "GREAT WEST" or "ICMA DEF COMP", or other names, depending on the employee selected vendor and the individual amounts were listed but would total the same as the Gross Earnings side. These descriptors changed from time to time over the years depending on payroll practice and few employees felt obligated or able to understand the complexities of the paystubs other than overtime, vacation amounts, longevity pay, regular pay and deferred wages, or total amounts of compensation all listed under Gross Pay, less the taxes and deductions which included "DEF COMP." To the best of my knowledge, all deferred compensation amounts showed on employee paychecks as compensation, and there was a deduction on the deduction side of the paychecks which included the amount paid to the deferred compensation vendor selected. Over the years following 1994 there were several payroll systems changes and if the payroll department was asked about changes, the normal response would be "don't worry about it, that is just how we show it."

5. I remember asking Karl Nollenberger specifically in negotiations prior to settlement "will this deferred comp count towards PERA?" and Nollenberger answering "Yes." I was aware that a sizeable portion of his compensation was in deferred compensation and had no reason to doubt that he was well versed in the nuances of compensation law. My concern was to satisfy my own required due diligence as President of the CDSA to ensure that I was not recommending any contract that would damage my members. I chaired the CDSA group meetings to explain the proposed contract and one specifically for the purpose of contract ratification and was asked that question in the meetings by employees, including I believe, Bob Larson. I assured him and other members that the deferred compensation was in fact, PERA eligible.

6. The CDSA unit approved the contract, and in 1995-1996 the contract provided in Article 12 that employees were entitled to receive additional compensation in the form of deferred compensation. In 1995 each employee received \$25.00 per month, and in 1996 each employee received \$50.00 per month as part of their total compensation package. Those dollars were reflected on pay stubs as simply DEF WAGES under Gross Earnings and were included on the Deduction and Taxes side under DEF COMP. Dollars earned under article 12 were not segregated from other earnings participants designated to deferred compensation vendors, they were simply included as a total sum of dollars sent to the vendors chosen by the employee.

7. In an entirely separate section of the Agreement, the City also promised to pay, on behalf of each employee, the entire cost of single self-funded hospitalization and medical coverage for employees without dependents. For employees who had dependents, the City would contribute \$300.00 toward the self-funded family coverage. However, this provision had no connection to Article 12.

8. As I understand it, after this benefit was included in the 1995-1996 CDSA contract, Nollenberger added the same deferred compensation provision to other collective bargaining agreements. As we approached the next contract cycle, I was still negotiating on behalf of the Supervisor's Association. Apparently Nollenberger had awarded a similar amount of deferred compensation to the AFSCME contract of 1995-1996 and included an option for employees who were eligible for and had elected family coverage to divert some or all of that deferred compensation toward family medical costs if they were eligible for family coverage and if they chose to do so. Although I opposed that provision being added to the CDSA contract, the City subsequently offered and the

CDSA membership approved a contract that included that language. There was no direct relationship between those deferred compensation funds and medical insurance premiums, members could pay the medical premiums with their regular pay, they could elect to reduce deferred pay under article 12 and use it instead to pay premiums, they could reduce earnings previously designated to deferred compensation and use those to pay premiums and leave the Article 12 amounts to flow to their chosen vendor or any combination of these funds as they so chose. They were all included under Gross Earnings and the employee portion of medical premiums were included under Deductions and Taxes. If ever there was linkage between the Article 12 dollars and medical coverage premiums, it was created by timing, by the fact that with each new contract, Article 12 dollars would change and medical coverage premiums would change at the same time. The City mitigated the sting of annual premium increases by suggesting in contract negotiations that additional Deferred Comp could be used to pay a part of them, much as a car dealer might advertise a lower purchase price but include in small print "after your trade or \$2,000 down." There was no direct relationship. Nor was the additional Article 12 money ever intended to compensate employees who were ineligible or chose not to receive the more costly family coverage. The CDSA already had in their contract a differential amount intended to balance employee compensation for medical coverage between employees receiving single coverage and those eligible for and electing family coverage. Between 1995 and 2001, Article 13 of the CDSA contract provided that the City provided full reimbursement of employee single medical and hospitalization changes. If an employee was eligible for and elected family medical and hospitalization coverage, the City would pay a set dollar amount up to a contractual cap to the employee

for family coverage, with the balance being paid by the employee through payroll deduction. For the employee with single coverage, an additional amount was paid as a single/family differential. That provision was later negotiated away.

9. Since the 1980's, the City of Duluth has provided a self-funded medical and hospitalization reimbursement plan. It has not purchased insurance, or operated an insurance plan. The City of Duluth provides a "pay-as-you-go" medical reimbursement plan, and attempts to set aside reserves for payment of claims. The City has purchased third-party administration of the medical reimbursement plan from Blue Cross Blue Shield, or Medica, or other administrators. However, the City has never operated insurance and to my knowledge is not subject to the regulation of any insurance laws or agencies as an insurance plan.

10. Between 1995 and 2000, the CDSA contract provided that a single person or a person with family coverage was always entitled to a fixed dollar amount of deferred compensation. Only those persons who were eligible for family coverage and actually elected family coverage were given an option to divert some of their Article 12 deferred compensation to the cost of family coverage above the amount paid by the City of Duluth.

11. I believe the State Auditor's office had an annual function of examining the books and records of the City of Duluth including a payroll audit. Each year approximately 25 payroll transaction numbers were provided to the City Finance Department by the State Auditors, and the City had to respond with supporting documentation including time sheets, deductions, withholdings, and copies of all related checks and copies of all employee contracts for the purpose of determining that the payroll complied with the contracts, with the law, and with the documentation of the

work performed . To my knowledge, in all those yearly payroll audits the State Auditor never determined the deferred compensation plan to be out of compliance with any legal or PERA requirements. I do recall hearing that the City of Duluth instituted a new payroll system for its 1,400 employees in late 1997. Once the software was installed and in place for one year, I was told an audit took place 1998. I was told there were no issues raised at any time by the Office of State Auditors as a result of that audit of payroll regarding PERA contributions. I do recall hearing that the City Finance Director and the auditors met with the State Auditor with regard to a question raised in about 2001, and the State Auditors were satisfied after their inquiries that the deferred compensation plan was in compliance, and removed the issue from any audit reports.

12. During staff meetings which occurred when I was Chief Administrative Officer during 2006 and 2007, department heads were repeatedly asked to brainstorm for reductions of expenditure or to create revenue for the City necessitated by reductions in State local government aid and reduction in the Police and Fire PERA amortization aid payments in 2008. I believe a result of these questions may be when Wayne Parsons offered an opinion that somehow the deferred compensation was not “in compliance.” However, Parsons never suggested to me any basis for this non-compliance, either legal or financial. He never suggested the City had to make any reports or notification. He never suggested the City had a duty to go back, audit or change any contributions already made by the City on behalf of active employees or retirees and received by PERA. I do believe he commented to me personally on one occasion that we may not be in compliance with current PERA regulations as to contributions to PERA on deferred compensation. I believe I responded that we should do what is required to bring the City

into compliance. As I recall, his concern was what to tell the Unions. This was during difficult contract negotiations and my response was to simply change our practice as required to be in compliance and to do so without consultation.

13. To the best of my knowledge, City paystubs have always shown deferred compensation wages as part of gross compensation subject to social security, and have also shown the amounts to deferred compensation vendors on the deduction side.

14. To the best of my knowledge, the compensation amounts paid to employees were always subject to social security at the time of payment. There was never any employer “match” but the payment was made to the employee unconditionally as part of total compensation set forth in the collective bargaining agreements.

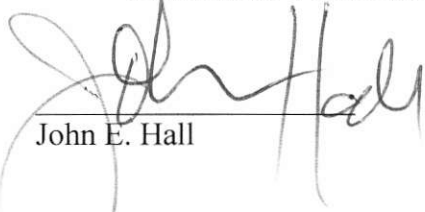
Employees who were not part of a collective bargaining unit were typically provided with similar benefits by City Council resolution. The deferred compensation products allowed employees to withdraw the funds for hardship prior to retirement, subject to penalties and taxability. There was never a required additional contribution by the employee. The funds were available to be withdrawn as loans to the employee prior to retirement.

15. To the best of my knowledge, the City of Duluth in all its Collective Bargaining Agreements and with all non-contract employees has provided single medical and hospitalization reimbursement. The City of Duluth has never paid to employees or provided family medical and hospitalization reimbursement coverage. The City provides some dollar amount of contribution to employees in contracts, which amounts may be applied to the cost of family coverage if the employee is eligible and so elects the coverage so long as the employee pays the balance. In the deferred compensation contract provisions, the City essentially paid cash amounts to the employee which were

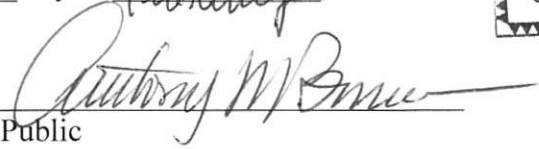
included in the employee's social security wages, as part of the employee's salary, and then deducted the deferred compensation amount from the gross wages and paid it to the designated deferred compensation provider. If an employee was already designating wages to deferred compensation, the deduction portion of the paystub would show the total contribution to deferred compensation, not distinguishing between Article 12 payments and wages the employee was already designating to deferred compensation. No additional or match contributions were ever required.

16. I have received different calculations from PERA concerning the correct amount of my annuity. They are inconsistent. My annuity was reduced by \$251.34 per month or \$3,016.08 annually on May 18, 2009, and I have been advised I will need to reimburse \$13,160.80 calculated as of December 31, 2008. I never participated in the family medical reimbursement plan.

FURTHER YOUR AFFIANT SAYS NOT.


John E. Hall

Subscribed and sworn to before me this
10 day of February 2010.


Notary Public

