

KM **KENNERLY MONTGOMERY**
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December 21, 2010

Pugh & Company, P.C.
Suite 200
315 N. Cedar Bluff Road
Knoxville, Tennessee 37923

Re: City of Knoxville Pension Board (1825-011)

Dear Sirs/Ladies:

By letter dated November 24, 2010, Michael A. Cherry, Executive Director, acting on behalf of the City of Knoxville Pension Board (the "Pension Board"), asked that we furnish you with certain information in connection with your examination of the account of the City of Knoxville Employees' Pension System (the "Pension System") as of June 30, 2010, as well as subsequent developments since that date to the date of this letter.

Except for the cases summarized below, please be advised that this firm is not devoting substantive attention on behalf of the Pension Board to any other pending or threatened litigation, claims or assessments in amounts in excess of \$25,000.00 involving the Pension Board. This was true as of June 30, 2010 and continues to be true as of the date of this letter.

This firm is defending the Pension System on a Petition for Writ of Certiorari and Judicial Review in the Knox County Chancery Court styled Glenda S. Fields v. Michael A. Cherry, Executive Director City of Knoxville Pension Board, Docket No. 164267-1. This action was filed by a former police officer of the City of Knoxville challenging the administrative decision of the Pension Board denying the employee's application for an in-line of duty disability benefit under the City of Knoxville Charter. The Pension Board awarded the former employee a not-in-line of duty disability benefit because the Pension Board believed the claimed injuries were not permanent and because it determined that the former employee failed to prove the alleged injuries were incurred in the line of duty. On December 9, 2010, the Pension Board agreed to settle this matter with the plaintiff subject to the execution by the parties of an appropriate settlement agreement and release. The terms of the agreement include the Pension Board's commencement of a monthly in line of duty disability benefit on November 1, 2010 (calculated as if it had been awarded as first claimed) and the payment of ninety-five percent of the additional amount that would have been paid to the defendant prior to November 1, 2010 had the in line of duty benefit been originally awarded (without interest for the over five year period this case has been pending). The settlement agreement is being prepared at this time and an order dismissing the case will be entered once that agreement is signed by the parties.

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This firm is also defending the Pension System on a Petition for Writ of Certiorari filed on July 12, 2010 in the Knox County Chancery Court styled "City of Knoxville v. The City of Knoxville Pension Board, et al, Docket No. 178203-2. This lawsuit challenges the legal authority of the City of Knoxville Pension Board to make an error determination under the City of Knoxville Charter § 1352.3 and to remedy that error. The lawsuit resulted from the Pension Board's action in that regard on May 13, 2010, at which time it granted relief to approximately 40 current and former employees that it determined were affected by the error. This firm has filed an answer for the Pension System and the matter is scheduled to be heard in January of 2011. The Pension System's fiduciary insurance company is providing the cost of defense on the matter after the payment of the policy deductible so the legal expenses to the system are not expected to exceed \$10,000.00 for this litigation. The decision that was made by the Pension Board will result in an actuarial cost to the system that will be recognized over a period of many years and which is currently being reviewed by the parties and in dispute. If the court determines that the Pension Board exceeded its authority in making the error determination that it did or in how it chose to remedy such error, that cost (whatever amount it is determined to be) will not be incurred by the Pension System, but there would be no damages or other monetary penalties as a result of a court decision that is adverse to the Pension Board. At this time it is not possible to predict with any accuracy the likely outcome of this case or to quantify the actual annual cost to the Pension System of the Pension Board's decision that gave rise to this action.

This firm also advised the Pension Board during the audit period under review on a securities litigation case styled In re Stone Energy Corp., Civil Action No. G:05CV2088, filed in the United States District Court for the Northern District of Louisiana. In this matter, the Pension Board filed a motion on April 13, 2009 to be the substitute lead plaintiff for this class action suit, which was eventually entered by the court. That case was then settled in late 2009 and resulted in the defendants paying \$10,500,000 into a settlement fund, which will be administered pursuant to the court approved settlement plan. The Pension Board is entitled to claim against the settlement fund for its losses, which claim is pending. At this time it is not possible to accurately estimate what the Pension Board's recovery will be, but it is anticipated that it will be below the estimated \$89,000 in stock losses that resulted to the Pension System as a result of the defendants' corporate malfeasance that gave rise to this class action litigation.

Furthermore, our records reflect that as of June 30, 2010 the Pension Board's account with this firm showed a balance due of \$15,038.50, which account was subsequently paid in full and on time.


This response is limited by, and in accordance with, the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (the "Statement"). Without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response (Paragraphs 2 and 7) are specifically incorporated herein by reference, and any description herein of any "loss contingencies" is qualified in its entirety by Paragraph 5 of the Statement and the accompanying commentary (which is an integral part of the Statement). Consistent with the last sentence of Paragraph 6 of the Statement and pursuant to the Pension Board's request, this will confirm as correct the Pension Board's understanding as set forth in its audit inquiry letter to us that whenever, in the course of performing legal services for the Pension Board with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, we have formed a professional conclusion that the Pension Board must disclose or consider

disclosure concerning such possible claim or assessment, we, as a matter of professional responsibility to the Pension Board, will so advise the Pension Board and will consult with the Pension Board concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards No. 5.

Finally, we do not undertake to advise you of any changes in our response resulting from matters that may be brought to our attention after the date of this letter.

Sincerely,

KENNERLY, MONTGOMERY & FINLEY, P.C.

By 
C. Coulter Gilbert

CCG:cp

cc: Michael A. Cherry, Executive Director
City of Knoxville Pension Board