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SUBJECT: Charter Section 143 Amortization Limitations for Past Service Liabilities

PREPARED BY: City Attorney

INTRODUCTION

This opinion analyzes legal issues associated with Proposition G that amended San Diego City Charter Section 143 to mandate, among other things, a maximum 15-year amortization period for costs associated with net accumulated actuarial losses of the pension system. Proposition G becomes effective July 1, 2008. Accordingly, this opinion will discuss whether the provisions of Proposition G can be harmonized with the California Pension Protection Act of 1992, a state constitutional provision granting retirement boards plenary authority over investment and administration of retirement systems.

QUESTION PRESENTED

Is the City of San Diego bound by provisions of Proposition G that amended San Diego City Charter Section 143 to mandate, among other things, a maximum 15-year amortization period for costs associated with net accumulated actuarial losses of the pension system in light of the California Pension Protection Act of 1992[1]?

SHORT ANSWER

Yes. Proposition G's requirement that the City amortize net accumulated actuarial losses on no greater than a 15-year period is legally binding, and such requirement is not contrary to the provisions of the California Pension Protection Act. Proposition G's mandate of a maximum 15-year amortization period for net accumulated actuarial losses does not usurp or unduly interfere with the retirement board's plenary authority and fiduciary responsibility over the investment of monies and administration of the system as provided for under the California Pension Protection Act. Like Government Code section 31453.5[2], Proposition G simply establishes an upper boundary for the amortization of pension debt. The retirement board retains

[1] Article XVI, section 17 of the California Constitution.
[2] Government Code section 31453.5 provides a limit of 30 years for county retirement boards to amortize unfunded pension liabilities.

sole and exclusive power to provide for actuarial services. The system actuary retains the discretion to make recommendations regarding mortality rates, disability, turnover, retirement rates, rates of investment and such other matters to the San Diego City Employees' Retirement System board, which such board may adopt, including amortization periods of less than 15 years.

BACKGROUND

In 1927, the City of San Diego [City] established the San Diego City Employees' Retirement System [SDCERS], an employee retirement system for its officers and employees. SDCERS is administered pursuant to San Diego City Charter sections 141 – 148.1, Article X, Section 1, and the San Diego Municipal Code Sections 24.0100 *et seq*. SDCERS provides retirement, health insurance, disability and death benefits to its members and their beneficiaries. The City's retirement plan is a defined benefit plan. The City provides retirees an annual allowance based on years of service and annual earnings. In order to provide retirement benefits to employees as they retire, the City is obligated to make annual contributions to SDCERS as calculated by the SDCERS actuary.

SDCERS functions as a trust whose beneficiaries are current employees and retirees of the City. The San Diego City Council [City Council] is responsible for determining the level of benefits and required contributions for its members. However, the trust is administered by the SDCERS Board [Board], not the City Council. The Board has a fiduciary duty to the employees and beneficiaries to ensure that the plan remains actuarially sound. These responsibilities include overseeing the proper investment of the assets as well as ensuring the timely payment of retirement benefits. The Board is also responsible for retaining an actuary to determine the value of the plan's assets and liabilities. Based upon certain actuarial assumptions, the actuary determines the amount that will be required to be contributed by the plan sponsor to ensure that sufficient assets will be available to pay retirement benefits as they become due. *See* San Diego Municipal Code sections 24.0901-24.0903. It is part of the Board's fiduciary duty to evaluate and approve the methodology and assumptions recommended by the plan's actuary.

Over the past several years, the underfunding of the City's pension plan has triggered a wide-ranging debate within the City, voluminous reports and blue ribbon studies, and has led to a series of federal, state and local investigations. While the roots of the City's pension woes can be traced back to the early 1980s, the more recent causes are found in two principal agreements between the City and SDCERS that increased pension benefits while simultaneously allowing the City to pay less than the actuarial rates. The first of these agreements (commonly referred to as Manager's Proposal 1 or MP-1) was entered in 1996, and a subsequent agreement (commonly referred to as Manager's Proposal 2 or MP-2) was entered in 2002. At their core, these agreements represented gross violations of public trust by both the City as plan sponsor and by SDCERS as fiduciary for the trust assets.[3]

[3] The City Attorney has issued six interim reports on alleged illegal actions related to the City's pension system: Interim Report No. 1 Regarding Possible Abuse, Fraud, and Illegal Acts by San Diego City Officials and Employees (January 14, 2005); Interim Report No. 2 Regarding Abuse,

Issues surrounding the solvency of the pension system became widely known when the City was forced to withdraw a proposed sewer bond issue in the summer of 2003. Thereafter public disclosures [4] in early 2004 revealed, among other things, that the City's pension fund had accumulated a deficit estimated between $1.3 billion and $1.7 billion and that the City's annual contributions to its pension system would soon absorb a significant, and perhaps unsustainable portion of the City's general fund budget. As a result, the City and the SDCERS Board became involved in several lawsuits regarding the funding of the retirement system. The City ultimately settled these lawsuits at a cost of hundreds of millions of dollars. Finally, and more damaging still, revelations about the underfunding of the retirement system set in motion a chain of events that would force the resignation of a mayor, paralyze the City Council and cost taxpayers more than $50 million in investigations by private consulting firms to determine the causes of the City's pension debacle.[5]

Given widespread public concern regarding the management of the retirement fund by City officials and the SDCERS Board, a measure was placed on the November 2004 ballot. The measure was entitled Proposition G. It sought to impose certain financial controls over management of the retirement system. Most significantly for purposes of this opinion,

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Illegal Acts and Fraud by San Diego City Officials (February 9, 2005); Interim Report No. 3 Regarding Violations of State and Local Laws Relating to SDCERS Pension Fund (April 9, 2005); Interim Report No. 4 Regarding Additional Funding For Outside Professionals Reviewing Alleged Illegal Acts (May 9, 2005); Interim Report No. 5 Regarding the Legal Status of the Elected Officers Retirement Program (May 18, 2005); and Interim Report No. 6 Regarding the San Diego Employees' Retirement System Funding Scheme (June 21, 2005). Two other reports also are notable: Vinson & Elkins LLP Report, "Report on Investigation, The City of San Diego, California's Disclosures of Obligation to Fund the San Diego City Employees' Retirement System and Related Disclosure Practices 1996-2004 with Recommended Procedures and Changes to the Municipal Code" (September 16, 2004) [Vinson & Elkins Report], and Report of the Audit Committee of the City of San Diego, "Investigation Into The San Diego City Employees' Retirement System and the City of San Diego Sewer Rate Structure" (August 8, 2006) [Kroll Report].

[4] The City found errors in various financial statements for the fiscal year ended June 30, 2002. Certain of these errors were reported by the City to the nationally recognized municipal securities information repositories in filings dated January 27, 2004 and March 12, 2004.
[5] The culmination of these events was the entry of a cease-and-desist order against the City by the Securities and Exchange Commission [SEC] on November 14, 2006 (Administrative File No. 3-12478) for violations of the federal securities laws relating to misstatements and omissions about the magnitude of the City's pension liabilities.

Proposition G sought to impose a maximum amortization period of 15 years[6] for any unfunded pension liability.[7]

The purpose of this memorandum is to review the relevant provisions of law in order to determine whether Proposition G is legal in light of the California Pension Protection Act of 1992. Accordingly, this memorandum will review pertinent provisions of the City Charter, including amendments affected by Proposition G, the California Pension Protection Act of 1992 and such other matters of law necessary to render an opinion on the question posed herein. This memorandum discusses the most significant legal issues raised by the application of Proposition G's limitations to the SDCERS Board. [8]

The City Charter

The City of San Diego is established under a charter. The charter is the supreme law of the City, and under it the City can make and enforce all ordinances and regulations concerning municipal affairs. *Grimm v. City of San Diego* (1979) 94 Cal.App.3d 33 Charter authority is subject only to the restrictions and limitations imposed by the charter itself, conflicting provisions in the United States and California Constitutions, and preemptive State law. Within its scope, a charter is to a city what a state constitution is to a state. *Id*. at 37, citing *San Francisco Fire Fighters v. City and County of San Francisco* (1977) 68 Cal.App.3d 896. Article XI, section 5, subdivision (b) of the California Constitution grants charter cities the authority to provide for the compensation of its employees. Pensions relate to compensation and are municipal affairs within the meaning of the Constitution. *City of Downey v. Board of Administration* (1975) 47 Cal.App.3d 621, 629.

The City's charter sets forth the following statutory scheme with respect to the City's retirement system:

Section 141 states that "The Council of the City is hereby authorized and empowered by ordinance to establish a retirement system and to provide for death benefits for public officers and employees…No employee shall be retired before reaching the age of sixty-two and before completing ten years of service for which payment has been made, except such employees may be given the option to retire at the age of fifty-five years after twenty years of service for which payment has been made with a proportionately reduced allowance. . . ."

Section 142 directs the Board "to secure from a competent actuary a report of the cost of establishing a general retirement system for all employees of The City of San Diego."

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[6] Prior to the enactment of Proposition G, section 24.0801 required the City to amortize its unfunded pension liability over a period of "thirty years or less."

[7] A pension fund's unfunded liability is simply the difference between the system's assets and liabilities.

[8] Under Municipal Code section 22.1801, adopted by Ordinance No. 8969, "City Retirement" is a department of the City.

Section 143 sets forth City and employee contribution requirements for the City's retirement plan. As discussed in more detail below, after the enactment of Proposition G, Section 143 requires, among other things, that the City amortize net accumulated losses on no greater than a 15-year amortization schedule.

Section 144 grants the Council three distinct powers over the retirement system:

- Power to Appoint Members to the Board. The Council has the power to confirm seven citizen members to the pension board after appointment by the Mayor. Appointees must have the professional qualifications of a college degree in finance, economics, law, business or other relevant field of study or relevant professional certification. In addition, appointees must have a minimum of 15 years experience in pension administration, pension actuarial practice, investment managements, real estate, banking, or accounting.

- Power to Define Benefits. The Council is also vested with the power to enact general ordinances prescribing the conditions under which persons may be admitted to benefits of any sort under the Retirement System.

- Power to Define Certain Investment Categories by Class or Type. The Council has the power to define for the Board by investment class or type certain authorized investment categories, which are in addition to the investment categories which the Board has the exclusive power to define.

Section 146 empowers the Council to enact any and all ordinances necessary to carry into effect the provisions of Charter sections 141 *et seq*.

Proposition G

Proposition G was an outgrowth of findings contained in the report of the San Diego Pension Reform Committee, dated September 15, 2004, which examined the City's retirement system and made recommendations on how the City should pay for retirement benefits. Proposition G was endorsed by the Pension Reform Committee, and it was approved by approximately 53% of the voters at the November 2, 2004 election. Proposition G amended section 143 of the City Charter to require the SDCERS board to set certain amortization schedules for actuarial gains and losses on specified amortization periods. Prior to the adoption of Proposition G, the determination of amortization schedules had been left to the SDCERS actuary to recommend to the board. The text of the proposition is as follows:[9]

> The retirement system herein provided for shall be conducted on the contributory plan, the City contributing jointly with the employees affected thereunder. Employees shall

[9] Text added by voter approval of Proposition G is underlined.

contribute according to the actuarial tables adopted by the Board of Administration for normal retirement allowances, except that employees shall, with the approval of the Board, have the option to contribute more than required for normal allowances, and thereby be entitled to receive the proportionate amount of increased allowances paid for by such additional contributions. The City shall contribute annually an amount substantially equal to that required of the employees for normal retirement allowances, as certified by the actuary, but shall not be required to contribute in excess of that amount, except in the case of financial liabilities accruing under any new retirement plan or revised retirement plan because of past service of the employees. The mortality, service, experience or other table calculated by the actuary and the valuation determined by him and approved by the board shall be conclusive and final, and any retirement system established under this article shall be based thereon. Funding obligations of the City shall be determined by the Board on an annual basis and in no circumstances, except for court approved settlement agreements, shall the City and the Board enter into multi-year contracts or agreements delaying full funding of City obligations to the system. When setting and establishing amortization schedules for the funding of the unfunded accrued actuarial liability, the Board shall place the cost of the past service liability associated with a new retirement benefit increase on no greater than a fixed, straight-line, five year amortization schedule. Effective July 1, 2008, the Board shall place the cost associated with net accumulated actuarial losses on no greater than a fifteen year amortization schedule and the Board shall place the benefit associated with net accumulated actuarial gains on no less than a five year amortization schedule. Notwithstanding the above, the Board shall retain plenary authority and fiduciary responsibility for investment of moneys and administration of the system as provided for in article XVI, section 17 of the California Constitution. The setting and establishing of amortization schedules by the Board pursuant to this section is not intended and shall not be interpreted to preclude the City from issuing pension obligation bonds or other similar instruments containing repayment terms exceeding fifteen years.

Proposition G contains three mandates for the City and the Board:

1. The City and the SDCERS Board are forbidden from entering multi-year contracts or agreements which delay full funding of the retirement system, except for court-approved settlements.

2. Costs associated with the unfunded accrued actuarial liability with respect to past service liability associated with new benefit increases must be placed on no more than a "fixed, straight-line, five year amortization schedule."

3. Costs associated with net accumulated actuarial losses[10] must be amortized on no greater than a 15-year amortization schedule, while the benefit from gains must be amortized on no less than a 5-year schedule.

These changes are effective July 1, 2008.

The drafters of Proposition G were mindful of provisions of the California constitution which purport to grant authority over the administration of retirement systems to retirement boards. Specifically, Proposition G contained the following language: "Notwithstanding the above, the Board shall retain plenary authority and fiduciary responsibility for investment of moneys and administration of the system as provided for in Article XVI, section 17 of the California Constitution." This caveat was echoed in the City Attorney's impartial analysis which concluded that the setting of contribution rates is one of those responsibilities vested exclusively within the board of SDCERS. Proposition G does not change this and the SDCERS Board continues to set contribution rates.

The California Pension Protection Act

In 1992 California voters adopted the California Pension Protection Act of 1992 (the California Pension Protection Act or the Act). The Act amended Article XVI, section 17 of the California Constitution and significantly affected the roles of public agencies and their retirement boards.

Section 17 provides in pertinent part:

> Notwithstanding any other provisions of law or this Constitution to the contrary, the retirement board of a public pension or retirement system shall have plenary authority and fiduciary responsibility for investment of moneys and administration of the system, subject to all of the following:
>
> (a) The retirement board of a public pension or retirement system shall have the sole and exclusive fiduciary responsibility over the assets of the public pension or

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[10] Proposition G uses but does not define the term "net accumulated actuarial losses." The term "actuarial loss" means that variance in actual results from the actuarial assumptions that increases costs of the pension system. For example, actual investment earnings being less than assumed investment earnings or higher than assumed pay increases. Under Proposition G, we presume that actuarial gains (variances that result in decreased costs to the pension system) are factored into actuarial losses to yield a "net" number. The "net accumulated actuarial losses" may or may not be equal to unfunded accrued actuarial liability, which is the difference between the actuarial accrued liability and the actuarial value of assets available to pay such liability. In effect it is a measure of the cost of the benefits that have been earned to date but not paid for by the plan sponsor. See, Gauthier, Stephen, "An Elected Official's Guide to Employer's Accounting for Pensions and Other Post-Employment Benefits (OPEB)" (2005).

retirement system. The retirement board shall also have sole and exclusive responsibility to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries. The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.

(b) The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system. A retirement board's duty to its participants and their beneficiaries shall take precedence over any other duty.

(c) The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims.

(d) The members of the retirement board of a public pension or retirement system shall diversify the investments of the system so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so.

(e) The retirement board of a public pension or retirement system, consistent with the exclusive fiduciary responsibilities vested in it, shall have sole and exclusive power to provide for actuarial services in order to assure the competency of the assets of the public pension or retirement system.

(f) With regard to the retirement board of a public pension or retirement system which includes in its composition elected employee members, the number, terms, and method of selection or removal of members of the retirement board which were required by law or otherwise in effect on July 1, 1991, shall not be changed, amended, or modified by the Legislature unless the change, amendment, or modification enacted by the Legislature is ratified by a majority vote of the electors of the jurisdiction in which the participants of the system are or were, prior to retirement, employed.

(g) The Legislature may by statute continue to prohibit certain investments by a retirement board where it is in the public interest to do so, and provided that the prohibition satisfies the standards of fiduciary care and loyalty required of a retirement board pursuant to this section.

> (h) As used in this section, the term "retirement board" shall mean the board of administration, board of trustees, board of directors, or other governing body or board of a public employees' pension or retirement system; provided, however, that the term "retirement board" shall not be interpreted to mean or include a governing body or board created after July 1, 1991 which does not administer pension or retirement benefits, or the elected legislative body of a jurisdiction which employs participants in a public employees' pension or retirement system.

Article XVI, section 17(e) of the Constitution grants pension boards "sole and exclusive power to provide for actuarial services in order to assure the competency of the assets" of the public pension or retirement system. However, section 3(e) of the California Pension Protection Act explains that one of the purposes and intents of the measure is "[t]o give the sole and exclusive power over the management and investment of public pension funds to the retirement boards elected or appointed for that purpose, to strictly limit the Legislature's power over such funds, and to prohibit the Governor or any executive or legislative body of any political subdivision of this state from tampering with public pension funds." California Pension Protection Act §3(e). Thus, the overarching intent of the California Pension Protection Act was to protect the assets and the members or beneficiaries of public pension systems by insulating public retirement boards from political interference.

The legislative history of the California Pension Protection Act was set forth in *Singh v. Board of Retirement* (1996) 41 Cal.App.4th 1180 as follows:

> Proposition 162 [the Act] was 'an outcome of California's recent budget difficulties and the struggle to find the financial resources to meet budget shortfalls… Proposition 162 was placed on the ballot by those who opposed AB 702, which passed the Legislature and was signed by [Governor] Wilson.' [Cal. Sen. Office of Research Senate Publication No. 643-S, 'Analysis of November 1992 Ballot Propositions' (Analysis) at p. 18.]
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> Briefly, the proposition in question was in response to a bill which had permitted the Legislature and the Governor to use reserve funds in a retirement system (in this case, the state Public Employees' Retirement System, or PERS) 'to substitute for normal state payments required to fund the system-thereby freeing state money to help close the budget shortfall.' (Analysis at p. 18.) (Assem. Bill No. 702 also transferred PERS actuarial functions to the Governor by giving him the power to appoint the PERS actuary.)
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> The substitution of reserve account funds for state payments and the transfer of actuarial oversight powers away from PERS were 'viewed by opponents as unwise and unfair, and many called it one more "raid" on the pension system.' (Analysis at p.18.) Proposition 162 was thus intended by its proponents to insulate the administration of retirement systems from oversight and control by legislative and executive authorities, and also return control of the actuarial function to the

> retirement boards themselves. This 'increased level of independence would make the [retirement] systems less of a target for local and state officials looking for a way to balance a budget.' (Analysis at p.20.) *Singh v. Board of Retirement* (1996) 41 Cal.App.4th 1180, 1191-1192.

The constitutional amendment applies "notwithstanding any other provisions of law or this Constitution to the contrary." Art. XVI, section 17. Given its broadest interpretation, this means that any existing statute, charter provision, or public agency procedure that is contrary to the Board's authority over administration of a public retirement or pension system would be unconstitutional. Naturally, statutes that do not usurp or transfer the board's authority to decide on administrative matters are permissible.

Applicability of the California Pension Protection Act to Charter Cities

Under the municipal affairs doctrine contained in Article XI, section 5 of the California Constitution, charter cities are provided with a form of "home rule" exemption from general state laws regarding subjects that relate to "municipal affairs." However, because the California Pension Protection Act amends the California Constitution and not general state laws, it is applicable to all charter cities and it supersedes any conflicting charter sections, ordinances and resolutions. This office has previously advised that this constitutional section applies to the San Diego City Employees' Retirement System. 1992 Op. City Att'y 9; City Att'y MOL No. 93-109 (December 15, 1993).

Discussed below is the treatment of Proposition 162 in relevant case law and opinions of the Attorney General applicable to the question to be answered herein.

Judicial Interpretation of Proposition 162

In *Singh*, supra, the court analyzed whether the provisions of Proposition 162 repealed established rules of Civil Procedure through which courts reviewed local agency actions. There, the court reviewed a county board's decision denying a county employee a service-connected disability. The trial court entered judgment for the plaintiff, concluding that the plaintiff's injuries resulted while he was driving his truck to work. The defendant board appealed, asserting, among other arguments, that the provisions of Article XVI, section 17 of the California constitution gave the board the "plenary" power to determine retirement eligibility, and that such power could not be overturned by the Superior Court. In rejecting the argument of the retirement board, the court drew upon the often cited rule of statutory construction that repeals by implication are disfavored, citing *Droeger v. Friedman, Sloan & Ross* (1991) 54 Cal.3d 26, 43. The court also reviewed the legislative history of the California Pension Protection Act and concluded that nothing in the language or legislative history of the Act repealed established rules by which local agency decisions are reviewed by the superior courts.

Similarly, in *Westly v. California Public Employees' Retirement System Board of Administration* (2003) 105 Cal.App.4th 1095, the court considered whether the California Public Employees' Retirement Board System (CalPERS) had "plenary authority" under Article XVI, section 17 over the "administration of the system," which enabled it to exempt its employees from civil service, to issue its own employee pay warrants, and to issue stipend, salaries and other payments in excess of certain provisions of the Government Code. The facts at issue here were an attempt by the CalPERS board to, among other things, exempt at least 10 of its portfolio managers from civil service (contrary to California Constitution, Article XVI, section 7 and the uniform pay provisions of section 12470 of the Government Code), and to issue its own warrants payable from retirement system trust funds to pay such portfolio managers when the Controller refused to process the increases. The CalPERS board also attempted to increase the compensation of its board members to $400 per meeting, contrary to the $100 limit set forth in the Government Code. The State Controller sought declaratory and injunctive relief to prevent the actions of the CalPERS board. The trial court ruled that "the existing case law and background materials, particularly the ballot arguments, clearly indicate that the voters had intended to stop the raiding of the pension funds, not to grant the defendants unlimited authority to ignore state laws governing state employees." *Id.* at 1104.

On appeal and relevant for our purposes, the *Westly* court directed the trial court to enter judgment in favor of the Controller, ruling that the CalPERS board did not have plenary authority to avoid state laws governing civil service. The court concluded that the plenary authority granted to the CalPERS board encompassed the management of retirement fund assets and their delivery in the exercise of the board's fiduciary duties. But such authority did not extend to the compensation of CalPERS personnel. The court reviewed the legislative history of Proposition 162 and concluded that the purpose and intent of the legislation was to "'give the sole and exclusive power of the management and investment of pension *funds* to the retirement board selected or appointed for that purpose . . . and to prohibit the Governor or any executive or legislative body of any political subdivision of this state from tampering with public pension *funds*.'" *Id.* at p. 1110. Thus, the court concluded that the voter intent, as evidenced by the published ballot material, was to give the pension board authority to administer the investments, payments and other services of CalPERS, but not the compensation of the board or its employees. *Id*. at p. 1112.

Finally, in *Bandt v. Board of Retirement* (2006) 136 Cal.App.4th 140, the court of appeal considered whether the Board of Retirement for the County of San Diego (San Diego Board) violated its fiduciary duties to former County of San Diego employees and current members of the retirement association by agreeing to accept an interim valuation that would have the effect of lowering the county's annual pension contribution. The facts in *Bandt* involve the decision by the County of San Diego in March 2002 to increase pension benefits by approximately $1.1 billion. The increase in pension benefits caused the pension fund's funded ratio to decrease from 99.2 percent to 75.4 percent. The addition to the pension benefits would cause the employer contribution to increase from .81 percent of payroll for the 2002 fiscal year to 32.06 percent of payroll for the 2003 fiscal year. The County decided, in order to reduce the size of the new pension liability, to issue pension obligation bonds in the amount of $550 million and deposit the proceeds in the pension fund. The San Diego Board decided to conduct an interim valuation to give effect to the $550 million deposit to the retirement system. The effect of the San Diego

Board's action was to reduce the amount the County would have to contribute to the retirement system, absent the interim valuation.

Certain members of the retirement system, including former and current members of the retirement system, brought an action for declaratory relief challenging the San Diego Board's decision to adopt the interim valuation. Among the arguments raised was that the San Diego Board was constitutionally required to maximize the amount of money in the short run by refusing to conduct an interim valuation that would take into account the deposit of $550 million. Moreover, appellants argued that the decision by the San Diego Board to amortize the pension liability over a 30-year period violated principles of "intergenerational equity" in violation of the California Pension Protection Act. In rejecting these claims, the *Bandt* court concluded that nothing in the California Pension Protection Act requires that a retirement board maximize employer contributions at the earliest possible moment, and moreover, nothing in the act required that the San Diego Board act in a manner consistent with the principle of intergenerational equity. *Id* at 145. In addition, it is notable that the *Bandt c*ourt took notice of Government Code section 31453.5, which allowed the San Diego Board "to establish a reasonable amortization period for the system's unfunded liability, which may not exceed 30 years," as setting the state's maximum amortization periods. *Id.* at 158. In so doing, the *Bandt* court impliedly recognized that limits can be placed on the exercise of discretion by retirement boards regarding the amortization of pension liabilities.

Attorney General Guidance

The California Pension Protection Act was recently analyzed in an attorney general opinion. Attorney general opinions are not binding precedent and carry no force of law. However they are entitled to "considerable weight" because the Legislature is deemed to take notice of the views of the attorney general and would act to modify legislation if the views of the attorney general were contrary to the intent of the Legislature. *Freedom Newspapers v. Orange County Employees Retirement System Board of Directors* (1993) 6 Cal.4th 821, 829.

On October 4, 2005, the Attorney General issued Opinion No. 04-710 (88 Ops.Cal.Atty.Gen 165 (2005) [the "2005 Opinion"]) to address whether a city charter could require a board of a city's retirement system to (i) place the cost of past service liability associated with a new retirement benefit on a specified amortization schedule, and (ii) place costs associated with net accumulated actuarial gains and losses on specific amortization schedules.

The Attorney General concluded that a city charter may not require that a retirement board of a city's employee pension system place the cost of the past service liability associated with a new retirement benefit on a specified amortization schedule, or place the cost associated with net accumulated actuarial gains and losses on a time-specific amortization schedule. *Id.* at 165. The Attorney General noted that Proposition 162 contained a provision giving it supremacy over other provisions of law, including constitutional provisions granting charter cities control over municipal affairs. The Attorney General then cited subdivision (e) of section 17 of Article XVI, which provides:

> (e) The retirement board of a public pension or retirement system, consistent with the exclusive fiduciary responsibilities vested in it, shall be the sole and exclusive power to provide for actuarial services in order to assure the competency of the assets of the public pension or retirement system…

The 2005 Opinion defined "Actuarial Services" to include not only the "determination of the necessary amounts of contributions but also the scheduling of payments when a required contribution rate is amortized in order to guarantee the sufficiency of the system's assets over a period of time." Accordingly, the Attorney General stated that "[N]o room is provided in the Constitution for a city charter to require that a city's board of retirement adhere to a specified amortization schedule in providing its actuarial services. Such a mandate in the city charter would directly undermine a board's 'sole and exclusive power to provide for actuarial services." *Id* at 168. Based in part on the description of actuarial services, the 2005 Opinion concluded that retirement boards have plenary authority over amortization schedules.

On December 21, 2006 the Attorney General issued Opinion No. 06-808 (89 Ops.Cal.Atty.Gen. 270) [the "2006 Opinion"] on the question of whether the Board of Administration of the California Public Employees' Retirement System [the "CalPERS Board"] may extend the payment schedule for retroactive benefits beyond the average remaining work period of the employees eligible to receive the benefits without violating the board's constitutional duties to provide secure benefits to its members, minimize costs to employers, assure the competency of the assets of the retirement system, and protect the employees' contractual rights to an actuarially sound retirement system.

The Attorney General concluded that the CalPERS Board may extend the payment schedule for retroactive benefits beyond the average remaining work period of the employees eligible to receive the benefits without violating the board's constitutional fiduciary duties to provide secure benefits to its members, to assure the competency of the assets of the retirement system, and protect the employees' contractual rights to an actuarially sound retirement system. The 2006 Opinion rests much of its conclusion on the fact that under section 20812 of the Government Code the board was allowed a funding period of 30 years to amortize unfunded accrued actuarial obligations for current and past service. *Id* at 275. In effect, the 2006 Opinion concluded that the CalPERS board had authority under section 20812 to utilize a 20-year amortization period, regardless of whether such period would be beyond the average remaining work period of the employees entitled to receive benefits.

ANALYSIS

The question presented is whether Proposition G can legally mandate that the City amortize past service liabilities on no greater than a 15-year period in light of the California Pension Protection Act. For the reasons discussed below, it is concluded that Proposition G's mandate that the City amortize past service liabilities on no greater than a 15-year period is legal, and that such requirement is not contrary to the provisions of the California Pension Protection Act.

We observe preliminarily that when SDCERS presented its actuarial valuation dated June 30, 2005 (San Diego City Employees' Retirement System June 30, 2005 Actuarial Valuation for the City of San Diego (May 2006), herein the "Cheiron Report"), the actuary indicated that it had been advised by SDCERS fiduciary counsel that the *Gleason* settlement[11] "mandates the SDCERS funding method and amortization period." Cheiron Report p. 2. Further, the actuary stated that "the legal advice we have received indicates that the *Gleason* settlement mandates key components of the methods and assumptions used to determine the City's contribution for fiscal years 2006 through 2008. Specifically, the settlement mandates the contribution be based on the Projected Unit Credit (PUC) method of funding using a 28-year amortization for FY 2007." Cheiron, Report p. 4. From this we gather that the view of the retirement board and its fiduciary counsel[12] was that the *Gleason* settlement could act to restrict the discretion of future SDCERS boards. If such legal advice by SDCERS fiduciary counsel was correct, it means that the SDCERS Board could, without doing violence to the plenary authority and fiduciary responsibility of future boards, be bound to specific funding methods and to fixed amortization periods, and such restrictions presumably would not run afoul of the constitutional prerogatives granted to retirement boards under California Pension Protection Act. The *Gleason* settlement shows that the SDCERS Board was so advised and so concluded; Proposition G imposes no greater burdens on the SDCERS Board.

The fundamental rules of statutory construction apply to interpret charter provisions. *Oneto v. City of Fresno* (1982) 136 Cal.App.3d 460, 465. First, we should "ascertain the intent of the Legislature so as to effectuate the purpose of the law." *Select Base Materials v. Board of Equalization* (1959) 51 Cal.2d 640, 645. Second, the provision must be given a reasonable and common sense interpretation consistent with the apparent purpose and intention of the lawmakers, practical rather than technical in nature, which upon application will result in wise policy rather than mischief or absurdity. *United Business Com. v. City of San Diego* (1979) 91 Cal.App.3d 156, 170. Significance, if possible, should be attributed to every word, phrase, sentence and part of an act in pursuance of the legislative purpose, as "the various parts of a statutory enactment must be harmonized by considering the particular clause or section in the context of the statutory framework as a whole." *Moyer v. Workmen's Comp. v. Appeals Bd.* (1973) 10 Cal.3d 222, 230. "The court should take into account matters such as context, the

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[11] The "*Gleason* Settlement" refers to a 2004 settlement of several lawsuits captioned as follows, *Gleason v. San Diego City Employees' Retirement System, et. al.*, San Diego County Superior Court Case No. GIC 803779; *Gleason v. San Diego City Employees' Retirement System*, et. al., San Diego County Superior Court Case No. GIC 803837; and *Wiseman v. Board of Administration of the San Diego Employees' Retirement System*, San Diego County Superior Court Case No. GIC 811756. The actions asserted that the City had violated the City Charter and Municipal Code from the fiscal year ending in 1997 through the fiscal year ending in 2004 by failing to contribute required annual amounts to SDCERS, and that SDCERS had breached its fiduciary duties by entering into certain agreements known as Manager's Proposal I and II.
[12] The City Attorney has not been privy to the legal advice provided to the SDCERS Board by fiduciary counsel. See Report of the City Attorney dated February 22, 2006 entitled "Regarding Whether the City Attorney is Counsel to the San Diego Employees' Retirement System."

object in view, the evils to be remedied, the history of the times and of legislation upon the same subject, public policy, and contemporaneous construction." *Cossack v. City of Los Angeles* (1974) 11 Cal.3d 726, 733. Finally, it is noteworthy that since construction of a statute by officials charged with its administration is entitled to consideration, so are the opinions of the City Attorney construing the Charter provisions, like those of the Attorney General construing state constitutional and statutory law. *Worthington v. Unemployment Ins.Appeals Bd.,* (1976) 64 Cal.App.3d 384, 388-389.

Proposition G was endorsed by the Pension Reform Committee, and approved November 2, 2004 by approximately 53% of the voters. The principal thrust of Proposition G is to require the City to responsibly manage and fund commitments to the retirement fund. It does this in two ways. It outlaws multi-year agreements between the City and the SDCERS board that would delay funding of the retirement system. This provision was a result of widespread criticism levied at the ill-founded agreements between the City and SDCERS popularly known as MP-1 and MP-2, which allowed the City to pay "contracted" rates into the retirement fund rather than rates established by the system actuary.

As a companion limitation, Proposition G most significantly limits the amortization period associated with past service liability to 15 years. The limitations contained in Proposition G impose no greater burden on the SDCERS board than certain limitations and reservations contained in the City Charter. For example, the City Council retains the authority under the Charter to define by investment class or type certain authorized investment categories that are in addition to the investment categories which the SDCERS Board has the exclusive power to define. In addition, the City Council remains vested with the power to enact general ordinances prescribing the conditions under which persons may be entitled to benefits under the retirement system.

Proposition G does not usurp the SDCERS Board's authority to administer the retirement fund, nor does it unduly interfere with the board's ability to provide for actuarial services. The Board retains the exclusive authority to set contribution rates, and retains sole and exclusive power to provide for actuarial services. Nothing in Proposition G alters this. Indeed the actuary retains full discretion regarding the determination of contribution rates to guarantee the sufficiency of retirement system funds, including adjustments to mortality rates, disability, turnover, retirement rates, rates of investment and such other matters. But with the enactment of Proposition G, the actuary is not allowed to amortize any past service liability over a period greater than 15 years. The actuary retains full discretion to recommend an amortization period *shorter* than the 15-year limit of Proposition G.

Other constitutional provisions allow voters to alter in the most significant fashion the administration of the retirement system. Article XVI, section 17, subd. (f) of the Constitution provides, in pertinent part:

> "…[w]ith regard to the retirement board of a public pension or retirement system which includes in its composition elected employee members, the number, terms and method of selection or removal of members of the retirement board which were required by law or

> otherwise in effect on July 1, 1991, shall not be changed, amended, or modified by the Legislature unless the change, amendment, or modification enacted by the Legislature is ratified by a majority vote of the electors of the jurisdiction in which the participants of the system are or were, prior to retirement, employed…"

This constitutional provision was designed to give voters the right to approve changes in the composition of retirement boards containing elected retirees or employee members. Proposition G, section 3, subd (b). Thus voters have not surrendered all of their power; they may change the composition of retirement boards and in so doing achieve objectives that they believe are in the public interest. Voters are not limited as to when or on what basis they can exercise such power.

Along these lines, the City Council has the authority under Charter section 144 to define for the Board by investment class or type certain authorized investment categories which are in addition to the investment categories the Board has the exclusive power to define. Moreover, the establishment of such boundaries, to the extent they do not cause the SDCERS Board to breach its fiduciary duty, are entirely consistent with the retirement board's fiduciary obligation to ensure the competency of the system assets. The City Council also retains the power to appoint members to the SDCERS Board and to define benefits. Charter section 144.

Section 17 of Article XVI purports to grant to retirement boards the "plenary authority and fiduciary responsibility for investment of moneys and administration of the system." In addition, subdivision (e) of section 17 of Article XVI provides that "[t]he retirement board of a public pension or retirement system, consistent with the exclusive fiduciary responsibilities vested in it, shall be the sole and exclusive power to provide for actuarial services in order to assure the competency of the assets of the public pension or retirement system . . . " These provisions were adopted in response to actions by the Governor and California Legislature to use reserve account funds for state payments and the transfer of actuarial oversight powers away from the retirement fund. See *Westly, supra*. Much is made of the use of the term "plenary" and the fact that such term connotes "full, complete, absolute, perfect, unqualified." Black's Law Dictionary, 4th ed., p. 1313. In other words, the import of the constitutional provision is that retirement boards are independent bodies free from interference in the exercise of their fiduciary duties in the administration of retirement funds.

But as explained in *Westly* the grant of "plenary authority" to retirement boards does not necessarily constitute a grant of absolute power without limitation over all matters pertaining to pension administration. Thus, in *Westly*, the CalPERS retirement board did not have plenary authority to avoid state laws governing civil service, and thus pay high compensation to its employees. Similarly, in *Singh*, the court rejected the retirement board's position that Proposition 162's grant of "plenary" authority repealed certain rules of civil procedure involving the review of local agency decisions, including those of retirement boards.

In order to ascertain the import of this grant, "[w]e are directed to look to the language of the enactment first, giving the words their usual and ordinary meaning." *Williams v. Superior Court, supra*, 92 Cal.App.4th at p. 623. Only if the statutory language is susceptible of more than one reasonable interpretation do we resort to extrinsic evidence to determine the intent of the voters. We start with the language of Article XVI, section 17. Retirement boards are granted "plenary authority" over the "administration of the system" in the initial paragraph of the amendments to Article XVI, section 17. The paragraph is made "subject to all" of the subdivisions that follow. The subdivisions serve to limit and define the authority and responsibility granted in the initial paragraph.

The analysis provided in *Westly* regarding the meaning of this provision is instructive. In Article XVI, section 17, subdivision (a), the analogous phrase "administer the system" appears. It provides the board "shall…have sole and exclusive responsibility to *administer the system* in a manner that will *assure prompt delivery of benefits* and related services to the participants and their beneficiaries." (Italics added.) It is preceded by a provision granting the board "the sole and exclusive *fiduciary responsibility over the assets* of the public pension or retirement system…"

The *Westly* court continued. "…[I]n this context, the "plenary authority" that is granted over the "administration of the system" goes to the management of the assets and their delivery to members of beneficiaries of the system, not the remuneration of those who administer it." *Westly* at 1109-10. The court interpreted "plenary authority" with regard to the board's administration of the system within the context of its fiduciary obligations and the pension system's ultimate goal; the protection of assets in order to "assure prompt delivery of benefits and related services to the participants and other beneficiaries."

Subdivisions (a) and (e) contain analogous language. It provides that "[t]he retirement board of a public pension or retirement *system*, consistent with the *exclusive fiduciary responsibilities* vested in it shall have the sole and exclusive power to provide for actuarial services in order *to assure the competency of the assets* of the pension or retirement system" (italics added.).

Thus, from *Westly* we must read the context of subdivision (e) as relating to a retirement board's fiduciary obligations to ensure the prompt delivery of retirement benefits. Therefore it is reasonable that limitations placed on a system's actuary by the voters to limit amortization periods "in order to ensure the competency of the assets" are permissible. Although section (e) identifies the board as having the sole and exclusive power to provide actuarial services, the language should be read within the context of the board's fiduciary responsibilities with regard to the protection of assets in order to "ensure the prompt delivery of benefits and related services to the participants."

The *Westl*y court also noted that the intent behind the constitutional amendment could be found in its declaration of purpose, which in pertinent part states: "(f) To ensure that all actuarial determinations *necessary* (italics added.) to safeguard the competency of public pension funds are made under the sole and exclusive direction of the responsible retirement boards. *Id* at 1101-1102. The word "necessary" is defined as "an indispensable item: essential" and as "absolutely needed or required." Webster's 9th New Collegiate Dictionary. Applying this definition to "actuarial determinations *necessary* to safeguard the competency of …the pension funds…" it can reasonably be argued that, actuarially speaking, nothing is absolutely required or essential to assure the protection of assets and delivery of benefits to plan participants, except minimum contributions into the pension plan. But this is not to say that greater contributions by the plan sponsor would be or are constitutionally prohibited. Thus, although a retirement board may have the legal authority to establish the floor or the minimum payments in the discharge of its fiduciary obligations (i.e., assuring the protection of the assets and delivery to participants), it does not have the power to dictate a ceiling or maximum contribution rates. See *Bandt*, *supra.* This power remains a "municipal affair" of the City, inherent in its authority to establish a retirement system for its employees.

The reasoning contained in the 2005 and 2006 Attorney General opinions is unpersuasive. The 2005 Opinion adopted a definition of actuarial service that was not dictated by the language of the statute. The California Pension Protection Act grants to retirement boards sole and exclusive power "to provide for actuarial services." An ordinary reading of that language is that retirement boards have unfettered authority to hire the actuary. This reading is more in line with the historic backdrop of the California Pension Protection Act, where the Governor sought to replace the PERS actuary with one of his choosing. Nothing in the language of the California Pension Protection Act or its legislative history requires that a definition of "actuarial services" mean that plan sponsors lose the ability to establish maximum boundaries for the fiscal management of the retirement system.

The 2006 Opinion is inapposite to our inquiry. The 2006 Opinion is simply a restatement of the principle that retirement boards have some discretion to utilize longer periods to amortize pension liabilities, particularly when there is a statute on point granting that authority. While the 2006 Opinion restates the discretionary authority of retirement boards, the 2006 Opinion does not necessarily constitute a legal command.

The *Bandt* decision can be distinguished on the basis that its central arguments involved the San Diego County retirement board's decision to use an interim actuarial valuation in order to take into account the deposit by the county of an extra payment into the pension plan. In rejecting claims that the use of the interim valuation was illegal, the court rejected as an additional argument that retirement boards were required to adhere to a vague and undefined notion of "intergenerational equity." *Bandt* did not involve a voter-approved mandate such as Proposition G. *Bandt* cannot be read to stand for the proposition that the voters of a charter city have no authority to establish amortization limitations for the payment of retirement liabilities, provided such limitations would not cause a retirement board to breach its fiduciary obligations to its members.

It is noted that the *Bandt* court cited Government Code section 31453.5 in its decision. That provision of the Government Code provides that county retirement boards have the power "to establish a reasonable amortization period for the system's unfunded liability, which may not exceed 30 years . . ." The amortization limitations contained in Proposition G are very much the same as those in Government Code section 31453.5. It is simply an effort to establish an upper boundary for the amortization of pension fund liability. However, unlike the Government Code provision, Proposition G was approved by the voters and represents an organic change to the City's constitution.

In *Westly*, the court explained that the California Pension Protection Act was enacted primarily to give pension boards independence so pension funds would not be "raided" by legislative bodies. *Id*. at 1111. Similarly, in *Singh, supra,* the court limited the meaning of "plenary authority," recognizing that the voter intent behind the Proposition was to "(a) remove the Legislature's authority to make investment decisions, and (b) establish that a system's primary obligation was to its members and beneficiaries." *Id* at 1191. Nothing in the provisions of Proposition G constitutes a "raid" on the pension system, or in any respect grants to the City Council additional powers over investment decisions or the payment of retirement benefits.

CONCLUSION

Our analysis reflects an effort to give meaning to the expression of the voters approving Proposition G, and to determine whether its provisions can be harmonized with the provisions of the California Pension Protection Act. The amortization limitations of Proposition G are not contrary to the California Pension Protection Act, and even under the terms of Proposition G the SDCERS board retains "plenary authority and fiduciary responsibility for investment of moneys and administration of the system as provided for in Article XVI, section 17 of the California Constitution." Like Government Code section 31453.5, Proposition G simply establishes an upper limit on amortization periods for unfunded pension liabilities. Unlike the Government Code provision, Proposition G reflects an action not of the Legislature but of a vote of the people. The SDCERS board retains the exclusive power to provide for actuarial services, and such actuary is free to make determinations regarding mortality rates, disability, turnover, retirement rates, rates of investment and other such matters. Moreover, the system actuary is free to recommend to the SDCERS board amortization limitations shorter than the 15-year maximum contained in Proposition G.[13]

The language of Proposition G requires "the Board" to place the cost of past service liabilities on no greater than a 15-year amortization period. It is appreciated that there is some debate as to whether the SDCERS Board is bound by the provisions of Proposition G. And, while it is concluded that Proposition G is not contrary to the provisions of the California Pension Protection Act and thus is legally binding on the SDCERS Board, it is also concluded that, in order to give effect to the law, the City would nonetheless be bound to such 15-year

[13] The conclusion that the 15-year amortization period for net accumulated losses is legally binding on the City necessarily includes a determination that the other provisions of Proposition G are legally binding on the City and SDCERS. Thus the SDCERS Board is required to amortize the cost of the past service liability associated with a new retirement benefit on a fixed, straight-line, 5-year amortization schedule. And, the SDCERS Board is required to place the benefits associated with net accumulated gains on no less than a 5-year amortization schedule. Of course, the SDCERS Board is free to adopt more conservative fiscal controls than the minimums established by Proposition G.

period as sponsor of the retirement plan irrespective of legal arguments that may be raised by the SDCERS Board.[14] Our effort here is not to engage in hyper-technical readings of voter initiatives in order to disenfranchise the voters.

Finally, the following observation is made: The City's financial woes stem in large measure from its unwillingness to conform its financial affairs in accordance with the requirements of law. The City is again at a critical juncture, where the law (Proposition G) requires one thing, and the City government wants to do another. For example, the Mayor's Five Year Financial Outlook 2008-2012 ("Financial Outlook"), released on November 29, 2006 assumes " . . . the remaining term under the 30-year amortization established by the Gleason Settlement through fiscal year 2012. In other words, it assumes a 26, 25, 24, and 23 years amortization period for fiscal year 2008-2012, respectively." The Financial Outlook states that adherence to the 15-year limitation of Proposition G would have the effect of increasing the cost to amortize the liability by approximately $47 million annually. It is acknowledged that the provisions of Proposition G require hard choices. But of the myriad of hard choices that policy makers face, one such choice cannot be avoiding the clear requirements of law.

Respectfully submitted,

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[14] The City Attorney told the SDCERS Board on March 16, 2007 that the Board's approval that day of a 20-year time frame was unlawful because the board had "a legal obligation to follow" Proposition G. The City, however, can pay more into the system than SDCERS requests. Given SDCERS' approval of a 20-year time frame, the City legally must pay more into the system to comply with Proposition G. The City Attorney is unaware of any legal restrictions that would preclude the City from paying more into the retirement system. Indeed Proposition G commands this result.