Office of
The City Attorney
City of San Diego

MEMORANDUM
MS 59

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DATE: January 15, 2008

TO: The Honorable Mayor Jerry Sanders and Members of the City Council

FROM: Michael J. Aguirre, City Attorney

SUBJECT: Purchase of Service / DROP

ELECTED OFFICALS' PURCHASE OF SERVICE

Charter Section 12(f) states in pertinent part:

> Notwithstanding any other provisions of this Charter and commencing with elections held in 1992, no person shall serve more than two consecutive four year terms as a Council member from any particular district.

With regard to the Mayor and the City Attorney positions, the same term limits limitation are found in Charter Section 24 and Charter Section 40, respectively.

Even though the maximum amount of years a Mayor, City Council Member or City Attorney may serve the citizens of San Diego is eight years, many of these current and former elected officials will retire with thirteen years of "credible service." How is this possible? Through the purchase of service program. Current and former elected officials can and have purchased up to five additional years of service credits. With these purchases, these elected officials' "credible service" for retirement calculation is increased.

These purchase of service years by current and former elected officials clearly violate the respective Charter term limit provisions as these officials have and will retire from City service with "credible service" in excess of those provided by the term limit limitations of the Charter. Therefore, all purchases of service by former and current elected officials must be set aside.

PURCHASED SERVICE CANNOT BE USED TO SATISFY THE VESTING REQUIREMENT

Service credits purchased by City employees are being used for more then just increasing one's retirement annuity amount. The Municipal Code allows general employees to retire at the age of 55 (as opposed to 62) if they have 20 years of credible service. However, today, people with only 15 years of actual service and 5 years of purchased service credits are able to retire at the age of 55. As a corollary, employees can also use their purchased service years to enter into the Deferred Retirement Option Program, otherwise known as DROP (i.e. an general employee at age of 55 who as worked for the City for only 15 years.)

Employees are not guaranteed a retirement annuity from the City unless and until they have 10 years of credible service with the City. Despite this requirement, employees with only 5 years of actual service are vesting in the retirement system as the City is permitting the up to 5 years of purchased service credits to count towards the initial 10 years of service requirement for purposes of vesting in the retirement system. Therefore, under the current system, an employee who departs City service with only 5 years of actual service to the City, but who has also purchased 5 years of purchased service credits will be entitled to receive a lifetime annuity from the City's pension system.

These above practices violate the San Diego Charter. Article IX of the San Diego Charter was adopted in 1931 and governs the retirement of City employees. Originally, Article IX, §141 set forth the vesting requirements for the pension system, stating the following: "[I]n no retirement system, so established shall an employee be retired...before he reaches the age of sixty-two and before ten years of *continuous service*...." (San Diego City Charter Art. IX, section 141 (as adopted in 1931) (emphasis added)). The section made it clear that to become a vested member of the retirement system, an employee was required to work at a minimum, ten straight, uninterrupted years.

In 1994, City officials decided to make a change in Charter §141 for the benefit of certain City workers who had not served at least ten years in a row. Some employees, for example, had performed a year or more of military service during their vesting period, or had taken a leave of absence for personal reasons. As originally set forth in the Charter, the term "continuous service" acted to disqualify employees in those types of situations from the retirement system. Under this rule, even if a City employee worked nine years in a row, took a year off to perform, for example, National Guard duty, and then served another nine continuous years with the City, for a total of 18 actual years served, he or she would not yet be vested in the retirement system. The City desired to correct this inequitable result.

The City submitted Proposition D to the voters in a special municipal election on November 8, 1994. Proposition D sought to amend Charter §141 to delete the portion of the original Charter §141 which spoke of "continuous service" and in its place substitute the following language for general members (with a similar provision for fire and safety members): "No employee shall be retired before reaching the age of sixty-two years and before completing ten years of service for which payment has been made...." (San Diego Proposition D (1994)). The voters

overwhelmingly passed Proposition D, with 181,901 votes for and 69,935 against. (San Diego Resolution R-296287, p. 7).

The amended version of the Charter, as set forth in Proposition D, accomplished its purpose - allowing workers who take time off to vest once they have worked ten actual years. No argument can be made, however, that this amendment allowed "bought years" under the purchase of service provisions of this Municipal Code (discussed more fully in Part B, below) to qualify for the City pension before they had actually worked ten years. The "Argument in Favor of Proposition D" section of the Proposition D ballot pamphlet states as follows, in relevant part:

> This proposition would ensure that City employees would not lose their pensions if their employment were interrupted by reasons such as other employment, family leave or military service. This proposition also ensures that a City employee would have to work the required minimum number of years and make the required contributions in order to qualify for a pension at retirement age.

(San Diego Proposition D, "Argument in Favor of Proposition D" (1994)).

No argument against Proposition D was filed and none appeared in the ballot pamphlet. The argument in favor also specified that no substantive changes were to be made to the pension system, and that no pensions would be increased: "This proposition is a housekeeping amendment....It does not change current practice. It does not increase pensions for City employees. It does not cost you, the taxpayer, one cent."

Recently, in the case of *Robert L. v. Superior Court*, 30 Cal. 4th 894 (2003), the California Supreme Court has given clear guidance on the interpretation of propositions:

> In interpreting a voter initiative, [the court] applies the same principles that govern statutory construction. [The court] turn[s] first to the statute, giving the words their ordinary meaning. The statutory language must also be construed in the context of the statute as a whole and the overall statutory scheme in light of the electorate's intent. When the language is ambiguous, [the court] refer[s] to other indicia of the voters' intent, particularly the analyses and arguments contained in the official ballot pamphlet.

(*Id.* at 900-901).

It is clear that Proposition D was intended to assist workers who had broken up their years of service, but not allow a worker to qualify for the City Pension who had not actually worked the ten required years.

In 2002 City officials attempted to shorten the ten year timing requirement by amending the City Charter through a new proposition, Proposition C. Proposition C would have (if passed) amended the ten year timing requirement originally built into Charter §141 so that only five

years of actual service would be required. The voters rejected Proposition C, and the Charter was not amended. Thus, the ten year vesting requirement remains.

Any reliance upon Municipal Code Section 24.1312 would be misplaced as the Municipal Code cannot supersede the City Charter. Charter §146 empowers the San Diego City Council to "enact any and all ordinances necessary, in addition to the ordinance authorized in section 141 of this Article [establishing a retirement system], to carry into effect the provisions of that Article." However, while the City Council is empowered to enact retirement ordinances, it is not empowered to enact retirement ordinances that conflict with the Charter.

In *Montgomery v. Board of Admin., et al.,* 34 Cal.App.2d 514 (1939), the plaintiffs sued the San Diego City Employee's Retirement System Board of Administration to compel it to pay retirement benefits which they claimed they were entitled to under the provisions of the City's charter and ordinances. To resolve their claims, which were based upon retirement ordinances which conflicted with the City charter, the Court of Appeal for the Fourth Appellate District was required to construe the provisions of Charter §146. *Id.* at 520. The court reasoned and held as follows:

> The section grants to the city council power to pass ordinances proper "to carry into effect the provisions of this article." This quoted provision of the section gives the city council power to pass ordinances to administer and carry out the terms of the charter. It gives no authority to pass any enactment that conflicts with charter provisions. In view of that provision of the section, we must hold that it is only an ordinance that puts into effect charter provisions that is to have the same force and effect as though a part of and included in the charter; that *the section does not empower the city council to pass any ordinance conflicting with the charter or that may have the effect of amending it.*

(*Id.* at 521) (italics added.)

Thus, the language in Charter §146 that "any and all ordinances so enacted shall have equal force and effect" with the charter does not authorize the City Council to enact ordinances that conflict, modify, or amend the charter. Otherwise, it would violate section 3, subdivision (a) of article XI of the California Constitution, which requires that charter amendments be approved by a majority of voters. (*Id.* at 520.) More recently, in *Grimm v. City of San Diego,* 94 Cal.App.3d 33, 39 (1979), the court reaffirmed that Charter §146 only "gives the city council power to pass ordinances to administer and carry out the terms of the charter. It gives no authority to pass any enactments that conflict with the charter provisions."

PRIOR PURCHASE OF SERVICE NEEDS TO BE MARKED DOWN TO ACTUAL VALUE

Presently, San Diego Municipal Code Section 24.1312 allows for the purchase of up to five years of non-earned creditable service. In August 2007, SDCERS' actuary determined that prior purchase of service credits had been sold at $146 million below their actual cost. This was

despite the recognized employee labor organizations recognizing and agreeing to the cost neutrality of the purchase of service program. Specifically, the respective 2002 and 2003 memorandum of understandings for each of the unions codified this agreement when it stated a "[m]ember may purchase of up to five years of service credit by paying both employee and employer contributions in an amount and manner determined by the San Diego City Employees Retirement System to make the System whole for such time." (See Fire Local 145 MOU, Article 23, section 6B effective July 1, 2002; Local 127 MOU, Article 43, section 3 effective July 1, 2002; MEA MOU, Article 22, section 3, effective July 1, 2002; and POA MOU, Article 44, section 6C, effective July 1, 2003.)

Allowing the members to not bear the full cost of the purchase of service, violates the City's and SDCERS Board's constitutional and fiduciary duties to ensure the system is actuarially sound. (See, Article 16, Section 17 of the California Constitution; See Also, *Board of Administration of the Public Employees' Retirement System v. Wilson*, 52 Cal. App. 4th 1109, 1131 (1997) and *Valdes v. Cory*, 139 Cal. App. 3d 773 (1983).) Therefore, to ensure actuarial soundness, the already purchased years of service credits should be marked down to their actual value. Doing so adheres to the law's requirement that the purchase of service credits be cost neutral. Additionally, Section 24.1312 must be amended to specifically set forth the actual cost of these years of service credits on a going forward basis. The price would be based on investment return assumptions, salary increase assumptions, COLA assumptions and mortality rates. Additionally, it must be amended to state that the actuarial calculation of purchase of service must be individually calculated based on each purchasing member's age and length of service, not as currently priced across member classification, i.e., safety versus general. Finally, it must be amended to require a calculation premised upon an unmodified service retirement allowance and member final monthly rate of compensation for each year purchased. These proposed amendments are the only way to obtain cost neutrality of any purchase of service program.

DROP NEEDS TO BE MADE COST NEUTRAL

The City has a Deferred Retirement Option Program ("DROP") as provided for under Municipal Code Section 24.1401 *et seq.* Municipal Code Section 24.1401 (b) states that "DROP is intended to be cost neutral."

Per Municipal Code Section 24.1402(a), any employee who is eligible for retirement may participate in DROP. No assessment as to whether the City would be better served by having a City employee enter DROP vs. hiring a replacement employee vs. promoting employees etc. is required by the City. Because of this, the number of employees who have entered DROP has substantially increased.

In or around May 2004, Mercer performed an audit of the actuarial work of SDCERS. On September 22, 2004, Mercer issued a second addendum to the audit. In that addendum, Mercer states that "[b]ased on our evaluation, for Safety members, the DROP program is not cost-neutral. The value of the DROP benefit is 115 percent of the value of the benefit he would have earned by continuing to accrue service and pay increases." As for general members, Mercer states in their report that "[f]or the average general member entering DROP, the ratio of the

benefit value including DROP to the benefit value if the member didn't enter DROP is 111 percent at the end of the maximum DROP period."

On December 7, 2004, the Gabriel Roeder actuarial firm issued a memorandum entitled "Evaluating the Financial Impact of DROP." In that memorandum, Gabriel Roeder states their agreement with Mercer's assessment that DROP is not cost neutral.

DROP, as currently implemented, is not cost neutral. The continued implementation of DROP, as currently formulated, violates Municipal Code Section 24.1401. DROP needs to conform with law and be made cost neutral.

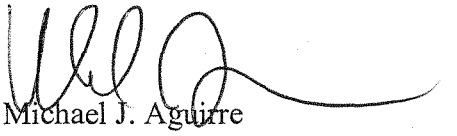
CONCLUSION

The City Council and the Mayor have a fiduciary duty to the citizens of the City of San Diego to ensure that they enforce the laws. As shown above, numerous pension benefits are being operated contrary to the law. Having knowledge of these facts, each of us, as an elected official, has a duty to correct past prior practices that violate the law and ensure that future violations do not occur.

Accordingly, with regard to the purchase of service program, numerous changes need to be implemented immediately. Specifically, all practices of using purchased service to meet vesting requirements need to be terminated. All practices of allowing elected officials to purchase service credits to either satisfy vesting requirements and/or increase their retirement annuity are also contrary to the law and need to be terminated. Prior purchases of service credits that have contributed $146 million to the retirement systems underfunded status needs to be marked down to actual value. Finally, DROP needs to be implemented in a cost neutral fashion.

The City Attorney's Office stands ready to provide the necessary documentation necessary to implement these changes.

MICHAEL J. AGUIRRE, City Attorney

By 
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